

THE RECOVERY AT FIVE YEARS: AN ASSESSMENT

HEARING

BEFORE THE

JOINT ECONOMIC COMMITTEE CONGRESS OF THE UNITED STATES

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THE RECOVERY AT FIVE YEARS: AN ASSESSMENT

TUESDAY, JULY 15, 2014

CONGRESS OF THE UNITED STATES,
JOINT ECONOMIC COMMITTEE,
Washington, DC.

The committee met, pursuant to call, at 2:03 p.m. in Room 216 of the Hart Senate Office Building, the Honorable Kevin Brady, Chairman, presiding.

Representatives present: Brady, Paulsen, Carolyn B. Maloney, Cummings, and Delaney.

Senators Present: Klobuchar, Lee, and Wicker.

Staff present: Corey Astill, Gail Cohen, Barry Dexter, Connie Foster, Niles Godes, Colleen Healy, Patrick Miller, Andy Nielsen, Robert O'Quinn, Andrew Silvia, Sue Sweet, and John Trantin.

OPENING STATEMENT OF HON. KEVIN BRADY, CHAIRMAN, A U.S. REPRESENTATIVE FROM TEXAS

Chairman Brady. Well, good afternoon, everyone. Vice Chair Klobuchar, Members, and distinguished witnesses, welcome to the Joint Economic Committee hearing entitled "The Obama Economic Recovery at Five Years: An Assessment."

This June President Obama's economic recovery turned five years old. Despite a near trillion dollar fiscal stimulus package, \$5.8 trillion in federal deficit spending, and a massive ongoing stimulus by the Federal Reserve, this recovery—while economic conditions have improved—is disappointing by all measures.

We all hope America gets back to work, but honestly it is difficult to find a metric on which the Obama recovery rates favorably. Wall Street is roaring, but Main Street and middle-class families are being left behind.

For most Americans, income growth has flat-lined. Since the recession officially ended, real after-tax income has edged up by only 4.4 percent a person. That is less than a third of the average recovery of the past half-century.

For middle-class Americans, this means that a family of four is missing \$1,120 from their monthly budget. They are in effect missing the equivalent of their monthly rent or mortgage payment.

Since the recession ended, those missing dollars exceed a whopping \$40,000 for that family. Can you imagine how many groceries, gasoline, and utility bills that would pay for? No wonder so many Americans feel like the recession has never ended for them.

So far, due to President Obama's Growth Gap, our economy is missing \$1.6 trillion in real GDP compared with the average of other recoveries since 1960.

This means America's economy is missing an economy larger than that of Australia, Spain, or Mexico. And if we do not begin successfully closing this dangerous Growth Gap, our Nation's economic hole will soon be larger than the entire economy of neighboring Canada.

Cumulatively, the overall loss in economic output in America is \$4 trillion, compared with again the average post-1960 recovery. That gap alone would qualify as the fourth largest economy on the planet. Can you imagine how much that missing economic growth would help American families today?

Can President Obama catch up? Can his economic leadership close the Growth Gap? We hope so, but it will be difficult. Just to qualify as the leader of an average C – grade economic recovery by the end of his presidency, real GDP will need to grow at an annual rate of 6.5 percent during each and every quarter. Unfortunately, the U.S. economy has only topped a 4 percent annual growth rate in two quarters of this recovery.

Disappointing economic growth means jobs are missing, too. Despite 52 consecutive months of private sector job growth as cited by Dr. Bernstein, the U.S. economy still suffers from a private sector jobs gap of 5.8 million jobs measured from the end of the recession.

These are Main Street jobs, not government jobs. And to put this staggering jobs gap in perspective, closing that gap would mean that every person searching today for a job in 44 states and the District of Columbia could go back to work.

Eliminating the jobs gap won't be easy, either, for the President. The U.S. economy would need to generate an additional 374,000 private sector jobs each and every month for the remainder of President Obama's presidency. Unfortunately, the White House hasn't achieved that even once during the recovery, and has broken the 300,000 private sector jobs per month mark only once—only twice, excuse me.

And while we all cheer the lower unemployment rate, unfortunately the decline is largely a mirage created by American workers leaving the workforce. Without the fall in the labor force participation rate to 62.8 percent since President Obama took office—which is a multi-decade low last seen when Jimmy Carter was in the White House—the unemployment rate would actually be 10.2 percent today, not 6.1 percent.

Those dropping out of the work force aren't the elderly taking early retirement; their participation rate has actually increased since 2007. It is the 16 to 59 year olds, both the young and prime working age individuals, whose participation has dropped. As a result, our labor force is missing more than 3.4 million workers between the ages of 20 and 59.

To the President's credit, from the end of the recession through April total employment has increased 5.7 million. Unfortunately, many more, over 11.3 million Americans, have been added to the food stamp rolls during the same period. This is not a hallmark of a strong, broadly based recovery.

Are recessions caused by a financial crisis difficult to recover from? Absolutely. And the President deserved time to let his policies work. But at this point, five years after the recovery officially began, the responsibility for this disappointing economy now lies squarely on this President. The excuse box is empty.

It is time to acknowledge that the President's seemingly insatiable appetite for more federal spending, higher taxes, and excessive red tape on local businesses has produced an economy sputtering along at near stall-speed. That has deprived millions of hard-working people, young and old alike, their opportunity to pursue the American Dream.

For the sake of millions of Americans seeking good jobs, we can no longer afford to simply stay the course. We need to roll back the damaging economic policies that the Obama White House has inflicted on the American people.

In closing, to get our economy back on track we need to return to the proven free market principles that built the most prosperous country on the planet. We need to implement the economic policies—lower marginal tax rates, federal spending restraint, balanced regulations, a sound dollar, and opening foreign markets to American exports—that got America moving again under both President Kennedy and President Reagan.

We need to remember the words that one of our distinguished witnesses today, Larry Kudlow, has uttered so often over the years: “free-market capitalism is the best path to prosperity.”

I look forward to the testimony today.

At this point, I would recognize the Vice Chair, Senator Klobuchar, for her opening statement.

**OPENING STATEMENT OF HON. AMY KLOBUCHAR, VICE
CHAIR, A U.S. SENATOR FROM MINNESOTA**

Vice Chair Klobuchar. Thank you very much, Chairman Brady, and thank you for holding this important hearing today.

I would like to welcome our witnesses, Dr. Jared Bernstein who is the Senior Fellow at the Center on Budget and Policy Priorities; and also Mr. Larry Kudlow. Thank you for being here.

We are here today to talk about the economic recovery, but I think it is important to discuss briefly just how far we have come.

The 2007 to 2009 recession was the longest and deepest recession in the post-war period. I think back to the first part of 2009 when our country was losing jobs at a rate of nearly 700,000 a month—literally, the population of Vermont. But five years after the recovery began, our economy has stabilized, and in some states it is actually expanding.

In my own State, the unemployment rate is better than average. It is at 4.6 percent. And the Twin Cities Metro area at 4 percent has the lowest unemployment rate of any metropolitan area in the country.

Yet still in our State, and across the country, we see families that are struggling to make ends meet. And we have much more work to do. I think we can get even better in Minnesota, and for that reason I think we have to look at an economic agenda for this country.

2013 marked the fourth consecutive year of economic growth, and recent economic news continues to be encouraging.

(Cell phone tone is heard.)

That was more news the Chairman was just getting. Just kidding. While the economy contracted in the first quarter, Federal Reserve Chair Yellen, who recently testified here, has attributed this to some temporary factors such as extreme winter weather. The Federal Reserve in fact expects economic growth to exceed 2 percent this year, and to be 3 percent or more next year.

Manufacturing, which is an engine of innovation and progress and generates 90 percent of all patents, has rebounded adding nearly 670,000 jobs since February of 2010—although, as we all know, it is not as it once was.

Exporting has been another bright spot. Exports have grown in each of the past four years. Housing starts are up more than 9 percent in the past 12 months, and the latest report on new single-family home sales shows they were at a six-year high.

The rebound in the housing market has helped households rebuild wealth lost during the recession. Net worth has increased at an average annual rate of 8.2 percent since the recovery began, and is now 12.6 trillion above the pre-recession peak.

The job market is also much healthier than five years ago. As our chart shows there on the screen, we have now recorded 52 straight months of private-sector job growth, the longest streak in history. With June's gains of 262,000 private-sector jobs, we have added 9.7 million private-sector jobs since February of 2010, more than were lost during the recession.

Employment growth has exceeded 200,000 jobs for 5 consecutive months, the first time that has happened since January of 2000.

For most workers, the prospects of getting and keeping a job today are better than they have been in a number of years. The number of unemployed workers per job opening has decreased from nearly 7 in July 2009 to 2.1 in May of 2014, close to the pre-recession level of roughly 2 unemployed workers for every job opening.

The unemployment rate nationally, currently at 6.1 percent, is down 1.4 percentage points over the past year, the largest one-year drop in almost three decades, as you can see from that chart.

Despite the improvements in the job market, we still have work to do. Long-term unemployment is still a very real problem. More than 3 million Americans, almost one-third of unemployed workers, have been out of work for more than 6 months.

We are making progress, but as we look at this, half the decline in the unemployment rate in the past year has come from a decline in long-term unemployment, and the long-term unemployment rate has now fallen to 2 percent.

As I said at the beginning of my remarks, I believe we need a long-term economic agenda for this country. Ramping up our work force and our education system I think is job one, especially from a state where our manufacturers, 67 percent of them, report job openings, trying to find workers with those skills, whether it's welding, whether it is fixing robotic equipment, whether it is running robotic equipment, to fill those jobs. That is up from 40 percent in 2010.

We have just recently in Congress, bipartisan, each passed some kind of work force opportunity Act, and I think that that is a good start, and there is more work to be done.

Passing the Immigration Bill will also be part of this solution. Comprehensive immigration reform would strengthen our labor force, boost productivity, and accelerate economic growth. Some estimates show that it would create 120,000 new jobs per year.

And then of course there is the deficit reduction, which is why I called Grover Norquist as a witness before this Committee. The CBO scores show that it will reduce the federal deficit by \$160 billion over 10 years, and around \$700 billion over the 10 years after that. We passed it in the Senate with 68 votes. We would really like to get it done in the House.

We also need to make it easier to afford college. There are various proposals out there for that, but that is clearly part of this building the work force, along with work force training and along with the immigration reform.

Raising the minimum wage to allow people to work their way out of poverty is key. And finally we need to bring down our debt, as Mr. Kudlow mentions in his testimony, and pass comprehensive tax reform, and bring down the overall corporate tax rate. I think we need to pay for it by closing some of the loopholes out there, but simplifying it, bringing down the rate.

And then finally, regulatory reform. We have seen that in tourism where we have suddenly seen a big boon because we have improved the visa approvals, and we would like to see it in other areas, as well. I will just add in "medical device tax" because I always bring it up every time we have a meeting. But I just think this kind of regulatory reform is very important, as well.

In conclusion, we have come a long way since the recession. I just do not think anyone can deny that. But we have a long way to go. And the most important thing I think we need to do is provide consistency for businesses so they can add jobs and try to get away from some of the short-term fixes as we go into the next year, passing more long-term tax reform and other things that will give businesses the consistency that they need to add jobs.

Thank you, Mr. Chairman.

Chairman Brady. Thank you, Vice Chair.

Votes have been called in the House. We have all been looking forward to this hearing for some time. After I introduce our distinguished witnesses today, I will turn the chairmanship over to Senator Lee. The House Members will vote. There may be a short recess. We will return just as quickly as these votes are over.

Larry Kudlow is a Senior Contributor for CNBC, the host of "The Larry Kudlow Show," and founder and CEO of Kudlow & Company, an economic research and consulting firm. He also hosted, as you know, CNBC's Prime Time Program, "The Kudlow Report." Mr. Kudlow started his professional career at the Federal Reserve Bank of New York where he worked in Open Market Operations and Bank Supervision. During President Reagan's first term, Mr. Kudlow was Associate Director for Economics and Planning at the Office of Management and Budget, where he was engaged in the development of the administration's economic and budget policy. He then served as Chief Economist and Senior Managing Director

of Bear Stearns & Company. Mr. Kudlow holds a BA in history from the University of Rochester. He also attended Princeton University.

Jared Bernstein is a Senior Fellow at the Center on Budget and Policy Priorities. From 2009 to 2011, Dr. Bernstein was the Chief Economist and Economic Advisor to Vice President Joe Biden; Executive Director of the White House Task Force on the Middle Class; and a key member of President Obama's economic team. Prior to joining the Obama Administration, Dr. Bernstein was a senior economist and the Director of the Living Standards Program at the Economic Policy Institute here in Washington. Between 1995 and 1996, he held the post of Deputy Chief Economist at the U.S. Department of Labor. Dr. Bernstein holds a Ph.D. in Social Welfare from Columbia University.

We are thrilled to have two economic experts and articulate leaders, thought leaders on the economy here today. I will recognize Mr. Kudlow for his testimony, and turn leadership of this hearing over to Senator Lee.

Thank you.

STATEMENT OF MR. LARRY KUDLOW, SENIOR CONTRIBUTOR, CNBC; FOUNDER AND CEO OF KUDLOW AND COMPANY, LLC, NEW YORK, NY

Mr. Kudlow. Mr. Chairman, thank you very much. I appreciate it. Everybody, thank you for your statements, Ms. Klobuchar, and our Republican Senators.

I will try to be as brief as I can. I agree that there is no question we are better than we were back in 2008 and 2009. I agree with that. That is undisputable.

But I will argue we can do a whole lot better. It has been a 2 percent recovery. It has been a 2 percent recovery which is either one of the slowest, or the slowest since World War II, or since 1960. And I think growth is about half of what it should be.

And I think coming off that dreadful crash in '08, we probably could be growing the economy as much as 5 percent for 3, 4, 5 years. I think the potential is there for it.

Frankly, while I fully agree we have had some much better news in nonfarm payroll jobs—undisputable—I just want to note, to me at least we are barely in recovery when it comes to business investment, Cap X, one of the most vital signs. It is also one of the best job creators. And this is the reason that I have been crusading and campaigning for significant corporate tax reduction and reform.

I do not know that that would solve all the problems, but I think it would solve a lot of the problems. We are losing cash, and we are losing plant and equipment to overseas. I hate to see it. But the reality is that these firms have to function to the best return of their shareholders, after tax.

And so if you have the highest tax rate, highest business tax rate among the leading countries in the world, you are going to lose. We are not hospitable. Our firms are leaving. You see it in the front page this morning, another pharmaceutical company wants a merger in order to relocate. I guess it's in Ireland. We're losing tech companies to Ireland.

So my point is a simple one. I would like to, at some point down the road, frankly, I would like to abolish the corporate tax in its entirety. I have seen a lot of work done on this. It is a very doable proposition. But for now, for now, I would recommend a 20 percent corporate tax rate, which would put us about on par with Great Britain. The UK has the best economy in Europe. They are growing a little better than 3 percent; 20 percent.

Canada's, I think, federal rate is 15 percent. That is where I would go. And I also would have full cash expensing; immediate writeoffs for cash expensing. And I would abolish every other deduction and credit in order to get that.

If you wanted to be revenue-neutral in static terms, or if you want to price it out in growth terms with a little supply-side effect, whatever you have to do, get rid of the deductions. And that is one of the reasons, if I can just put an advertisement in—it doesn't have a thing to do with the corporate tax—I am strongly in favor of abolishing the ExIm Bank and all other forms of corporate welfare. I just wanted to say that.

Now other areas, we have problems. You both noted it. Jared is a labor expert. The numbers have improved, but there are big holes in the labor story. There are big holes in the income story. There are big holes in the wages story. Big holes. And it has been a very, very weak recovery in the jobs area.

I will say—this is my view, editorial view, but I have been involved in economic policy on and off for a very long time—I believe that the government spending stimulus from the Federal Government, and the monetary stimulus from the Federal Reserve, failed. Both failed.

I believe these so-called “fiscal multipliers” failed. I believe the “money multipliers” failed. And particularly with the collapse of velocity and the risk aversion and the huge appetite for safe cash, it all failed. In fact, on money I am an ex-Fed guy, many, many years ago. If you look at the M2 money supply, it has not changed. It has been growing at 6, 6½ percent this whole period, even though the Fed's balance sheet, the monetary base, has increased by over \$3 trillion.

So I believe we would have been better off not intervening. I think the economy would have recovered faster. Now in the recent year or so we have had some increases in tax rates, and there are more to come, and that is not going to help the story either.

I am a guy who believes in monetary rules. John Taylor was just down here, a professor at Stanford, a good friend of mine. I think the Taylor Rule would be better for the Fed. I think the Fed should watch market prices such as commodities and gold and the Treasury Yield Curve, and the exchange rate of the dollar. I think they would do a lot better.

I agree with Professor Casey Mulligan of Chicago that redistributionism has contributed to this recession. I am in favor of a safety net, always have been. But I think the widening of eligibility under Mr. Bush and Mr. Obama has created incentives not to work.

And I think whether it is food stamps, or disability insurance, or long-term unemployment, I do not want to sound hard-hearted, but I think it is not in their interest to get off. The marginal tax rate

of getting off those programs can be as high as 80, 90 percent, and I think that has been another problem.

So I will just add, some lighter regulations. We can get into this later on. One point, finally, I'm an optimist at heart. I love to be an optimist. I do not see a recession. I do not see a recession. And I kind of hate it when people try to politicize the numbers. I have given you my best view on the economy, and it is no secret that I am a Reagan Supply Sider. I am not breaking any news there.

But I will say this. In terms of the, what I will just call the ultra-pessimist, I do not believe them, either. To me, when you see a positive yield curve in the Treasury Market, that signals continued expansion, albeit slow or moderate.

We have never had a recession without a negative yield curve. I just put that to the Committee. I think it is a very important point.

Secondly, we have had good news on the Stock Market, good news on corporate profits, and I do not see a Stock Market bubble. In fact, I do not see any bubbles right now. In fact, I think bubbles are the last thing we should worry about.

The generals always fight the last war. It is a very strange thing. That is true in the military, and I think it is true in economic policymaking. And I know it is true at the Federal Reserve.

So in that sense, I am somewhat optimistic. But I would just say to you: You cut corporate tax rates, and raise the value of the dollar about 10 percent; lower tax rates, stronger dollar, you can raise this growth rate and it can happen overnight. And people will start taking risks, and money will come back to the United States, and we can expand jobs, capital spending, investment, and all the rest of it.

Thank you. Sorry I went on a bit too long.

[The prepared statement of Mr. Larry Kudlow appears in the Submissions for the Record on page 40.]

Senator Lee [presiding]. Thank you very much, Mr. Kudlow.

Dr. Bernstein.

**STATEMENT OF JARED BERNSTEIN, Ph.D., SENIOR FELLOW,
CENTER ON BUDGET AND POLICY PRIORITIES, WASHINGTON, D.C.**

Dr. Bernstein. Chairman Brady, Vice Chair Klobuchar, I thank you for the opportunity to testify on this timely topic. It is an honor to be here with my old friend, Larry Kudlow, as well.

Thanks in part to countercyclical policies legislated in Congress in 2009, along with aggressive monetary policy by the Fed, significant progress was made early on in repairing the damage done by the uniquely deep recession that began in late 2007.

Slide one in my presentation shows how GDP crashed at the nightmarish rate of 8 percent in the fourth quarter of 2008. The Recovery Act was passed in the middle of the next quarter, and by the second half of 2009 real GDP was growing again.

The other figure in that first slide shows how employment losses began to shrink as the Act was implemented and jobs began growing in early 2010.

The next figure shows a broad set of analyses of the impact of the Recovery Act on real GDP, including many nonpartisan

sources, including our own CBO. On average, they find that in 2010 the Act added 2.5 percent to GDP.

These actions helped to pull the recovery forward and prevent the Great Recession from becoming the next depression.

The economic progress over the first five years of the recovery, while incomplete, are most evident in the job market, particularly in the recent acceleration in job growth shown in my next slide, and the decline in unemployment.

After 52 consecutive months of net private-sector job growth, non-government employment is up 9.7 million jobs since early 2010. Moreover, employment growth has accelerated in recent months. Payroll has added 1.4 million jobs in the first half of this year, their strongest 6-month growth period since late 1999.

Un- and underemployment are both down significantly over the recovery, as are other slack metrics that rose sharply in the downturn, including long-term unemployment and involuntary part-time work.

While part of that decline in unemployment was due to labor force exit, this negative trend has also stabilized in recent months and recent declines in the jobless rate are due to job seekers finding work not giving up the search.

In fact, private payrolls grew about 3 percent faster over the first 5 years of this recovery compared to the prior one, despite the fact that the recession that preceded this expansion was much deeper in terms of lost output and much longer lasting than the downturn that preceded the 2000s expansion.

The private-sector added 3.4 million more jobs in the first 5 years of this recovery than were added in the last one. And yet, slack remains in the job market and wage growth has generally not yet accelerated.

Corporate profitability and financial market returns, on the other hand, have more than recovered their losses. In other words, while there are certainly positive attributes to the current recovery—especially in relation to the depth of the recession that preceded it—it is clearly not yet reaching everyone.

Still, the evidentiary record shows that there should be no question that the quick and forceful policy actions taken by some members of this Committee and your colleagues back in the depth of the Great Recession were essential.

Since then, however, factions within this Congress have far too often blocked measures that could have built on this stabilization, like the American Jobs Act, or more recently Emergency Unemployment Compensation.

Worse, Congress has at times imposed self-inflicted wounds on the economy, including the government shutdown, sequestration, and the threat to default on our national debt.

As shown in my Figure No. 5, the imposition of these headwinds has blocked progress on growth, jobs, and wages at a time when the opposite was needed. In fact, many of the same policymakers who today criticize the economic progress I have documented have at the same time blocked legislative initiatives targeted at improving that progress.

It is one thing to critically point to the fire; yet quite another to do so while blocking the hydrant.

I would just summarize the message from my testimony as follows: When markets fail as massively as they did in the late 2000s, quick and forceful action clearly helped offset the damage. But to stop at stabilization instead of rebuilding jobs and incomes that were lost over the downturn is a serious policy mistake, one that has proven to be extremely costly to working families.

Still, there is time to build on the recent momentum we have seen, particularly in the job market. Now members of this Committee have suggested good ideas to help the recovery reach more people in the areas of job training, women's financial security and equal pay, manufacturing policy, and extending emergency unemployment compensation.

I would add investment in public infrastructure and increasing the minimum wage. Such measures would give the recovery a much better chance of reaching families that have seen too little of it so far, and surely we can all agree on the desirability of that outcome.

Thank you, very much.

[The prepared statement of Dr. Jared Bernstein appears in the Submissions for the Record on page 42.]

Senator Lee. Thank you, Dr. Bernstein.

Given the topic of today's hearing, I would like to focus at least initially on where we have been, and on some of the things that have contributed to where we are and where we have been in the last few years.

Dr. Bernstein, in your testimony you shared your belief that we should have had more fiscal stimulus in the early years of this Administration than we in fact had.

You know, as you know during the first three years of this Administration we added to the national debt, to the debt held by the public, by about \$4.5 trillion. So do I take from your testimony that means that you think we should have added to the national debt to a greater degree than that for the first three years of the Administration?

Dr. Bernstein. Well let me clarify. First of all, my point is not that we should have done more early on, as you suggested. I actually thought what we did was ample. I think it ended too soon.

So I think what was needed was, once the economy was stabilized, we needed to do more to build on that stabilization.

Now on your debt and deficit point, I would like to make a very, very important point that always gets overlooked in this conversation.

It is not "temporary measures" that add to our fiscal problems. And we have real fiscal problems. In fact, if you read today's Congressional Budget Office's Long Term Projection, there is no reference at all to temporary measures, many of which have expired, and in my view as I just said expired too soon. What hurts you on the fiscal front is not something that comes into the system and gets out of the system—"stimulus" is by definition temporary—it is the long-term pressures coming from say health care costs, and an aging demographic.

If you actually look at the contribution of the measures that I was advocating to the deficit or the debt, they are actually adding zero to the deficit at this point, and fractional to the debt.

Senator Lee. Okay, so you are not saying that we should have added more debt during that initial three years, during the first three years of this Administration?

Dr. Bernstein. Not during the first say two years. But starting in 2010, and I actually have a slide that shows this, starting around 2010–2011 and forward, that is when we should have been doing more on the fiscal side. Because at that point, fiscal policy was actually creating a significant drag on economic growth and holding back the stabilization effects that I thought we actually did handily in the first couple of years.

Senator Lee. So just to be clear, you would say that during that third year we should have done more, such that during that three-year window we should have added to the debt by an amount more than four point—

Dr. Bernstein. I want to be very—

Senator Lee. How much? How much More?

Dr. Bernstein. Well, first of all, I want to be very clear. When I talk about these kinds of measures that I am advocating, I am talking about temporary measures. And as I have stressed, the temporary measures that expire add nothing to the growth of the debt over the long term.

And, yes, I think we needed to do more to the tune of, let's just take 2013 as an example. In 2013, fiscal drag took 1½ percent off of GDP growth. Fiscal drag that, I would argue, Members of Congress were in no small part responsible for creating.

One-and-a-half percent of GDP equates to about half a percent of unemployment. That is over a million jobs. It is actually three-quarters of a percentage of unemployment. That is over a million jobs. So, yes, I would have done more temporary measures to help avoid the fiscal drag that has kept this economy from reaching more people.

Senator Lee. Including adding to the debt by an amount greater than what was added to during that period.

Dr. Bernstein. Certainly I am advocating more temporary fiscal policy that, once it expires, adds nothing to the budget deficit and nothing to the growth of the debt.

Senator Lee. Mr. Kudlow, what is your response to this? And what are the policies that you—

Mr. Kudlow. Well, look. Jared is a good friend, but we diametrically disagree. I just want to say a couple of things that come to mind listening to Jared.

2013 was the sequester. And if you go back and look at the press clips, and look at the CBO, we were supposed to have lost, I don't know, 700,000 jobs, 800,000 jobs. We didn't. We gained jobs. Job growth has been, you know, pretty steady in the last couple of years, 2 percent growth a year.

All the calamities that we heard about never occurred. In fact, the whole—what is so interesting to me is, as I said in my opening remarks, all this federal spending stimulus, and all this monetary stimulus, did not move the meter at all. We have been growing pretty steadily at 2 percent a year, which as I said is about half what we should have grown coming out of the deep recession. Maybe less than half. So I just don't buy it. I don't think it can be quantified.

People are talking about, you know, counterfactual scenarios, if we didn't do this it would have been worse. All I know is factually here's what we have. And it is not good enough.

I would have gone immediately into progrowth tax reform. That is what I would have done. And I would have let the countercyclical safety net work its way, as it did. In effect, you sort of doubled the safety net. And then it ran out and didn't seem to have any appreciable impact on economic growth.

That is why I argue, with all due respect, these multipliers don't work. They come from models that have been discredited, and they don't work. They didn't work in the past, and they don't work today.

I am surprised at some of the people on the Obama team that they went back and tried that. Less government, lighter regulation, greater tax incentives. If it pays more to work and invest after tax, you will work and invest more. These are the things that I think we should have been doing.

We should be revaluing the dollar, not devaluing the dollar. Here's a good point: The rate of spending has fallen. I like that. In fact, if I could think of one stimulus to the economy in the last few years, it's the fact that federal spending as a share of GDP has come down from a peak of close to 25 percent, 24½ percent, to actually less than 21 percent. I think it is about 20.6, 20.7 percent.

The deficit has also come down, but I am a guy who looks at spending. To me, that gives the private sector more room to grow, and the government absorbs fewer funds. That is a good thing, not a bad thing. So I, you know, have a different point of view with respect to my pal Jared on that.

And I also think it is never too late to have good policy. So the President has talked about corporate tax reform. Senator Klobuchar, you talked about corporate tax reform. Why don't you do it? Just go on ahead and do it.

You know, you don't have to do all of it in one fell swoop. What I am suggesting here, with great respect to my friend, Chairman Dave Camp, just work on the business side for now. Stop these firms from leaving. Stop them from taking the cash out of the economy. But you can't do that by penalizing them. They will just shut down, particularly in this environment where the animal spirits of risk taking are so low. People are still so risk-averse, you know, because of what we went through five years ago, six years ago.

Slash the corporate tax rate. Advertise it. Talk about it, and slash it. We could disagree about the exact point. I want 20 percent, you want 25, you've got a deal.

[Laughter.]

You want 28? Senator, I'd probably take it, but I think it's too high. I think the OECD average is about 25 percent. That's where I would go, but I would go lower than that just to make America more competitive. And get rid of all the K Street bells and whistles. Just get rid of them. We don't need them.

The Federal Reserve is ending its monetary stimulus in terms of bond buying. They are getting out of the bond business. This is good. It did not do a whit of good, not one whit. It did not change the growth of the economy. In fact, long-term interest rates went

up during most of these Quantitative Easings, not down, although they anchored the Fed Funds Rate at zero percent.

Here is a combination: You cut the corporate tax rate. Let the market move interest rates up at the short end and the long end, as they will, and you will have yourself a roaring recovery. I mean a roaring recovery.

Yes, this was the Reagan prescription. Yes, this was the John F. Kennedy prescription. And, yes, I believe it will work again. A critic of mine said, oh, it's so 1979. And I said, yeah, okay, pal. The way I look at it, it is so 1775. Remember the Boston Tea Party was about taxes, and the young Republic kept tax rates down.

Look, I believe the incentive model of growth works. And I also believe you have to have a king dollar. I don't want to lose money to these other currencies.

Senator Lee. Thank you very much, Mr. Kudlow.

Senator Klobuchar.

Vice Chair Klobuchar. Thank you very much, Senator Lee. Senator Lee and I chair the Antitrust Subcommittee of Judiciary, and this is a lot more fun. So thank you.

[Laughter.]

Mr. Kudlow, I want to start with something you raised, which is near and dear to my heart, because we have one of the companies that we love, Medtronic, that has actually—you know, we're fairly supportive of the fact that they are going to add 1,000 new jobs in our State as a result of this inversion, as well as \$10 billion over 10 years in investment. But obviously the concern that I have expressed, not about this particular deal but about the incentives that are going to continue that you have raised, is the fact that these companies have so much money overseas and we have to find a way to create new incentives.

And I view it the only way we really do this is with some kind of comprehensive tax reform. And so I wanted Dr. Bernstein's view on that, but I first just wanted to raise this idea of repatriation.

Mr. Kudlow. Yes.

Vice Chair Klobuchar. Let's say we cannot get the work done on comprehensive tax reform in the next four months, or something like that; that is going to take eight months, nine months—a big nine months; you can have a baby in nine months, so maybe we can get it done—

[Laughter.]

But do you think repatriation is worth looking at?

Mr. Kudlow. I do.

Vice Chair Klobuchar. Some of the oldtimers around here, you know, they say well the last time we did it the money went to the shareholders. They did not really invest—I am just telling you what they say.

Mr. Kudlow. I have seen this argument.

Dr. Bernstein. I think that is true.

Vice Chair Klobuchar. Yeah, okay—

Mr. Kudlow. I think it is partially true.

Vice Chair Klobuchar. Uh-huh.

Mr. Kudlow. And by the way, the fact that it is partially true does not make it bad. All right? If corporations pay dividends, or

share buy-backs to their investors, their investors generally do not put it under the mattress. They put it to work.

They might even start a new Medtronic. I am very familiar with that company, all of that company. I know your past and present CEO.

Vice Chair Klobuchar. Very good people.

Mr. Kudlow. They are, and they did a good job for the State and the country. The point I am making is, yes, we need repatriation. And, you know, there are two ways to go here. And I have heard both. Some people in Congress want a penalty, a really strong, stiff penalty, as though these companies were criminals.

They are not criminals. They are just acting on behalf of their shareholders under the current tax law, which I don't like, but they are doing what—or you can reward them by bringing the money home.

In the mid-2000s, I think the repatriation penalty rate was about 5¼ percent, something around that range. Okay? Go there. Go back there. You will get more bang now, by the way, because there is more money overseas. Ten years has elapsed. And if you go higher—I've talked to a lot of CEOs on my show, and I've talked to them through e-mail—you start getting up to the 10 to 15 percent, they back off. That's a lot for them. You look at the margin. You know, remember they're paying tax overseas, and then they get a credit against that. So really their net tax won't come down that much.

If you're in the 5, 6, 7 percent, 8 percent zone, most of these CEOs would play ball and they would bring the cash home.

Vice Chair Klobuchar. Okay, Dr. Bernstein, and I would also—there's some discussion about linking it to some kind of infrastructure funding as well, but why don't we talk about where repatriation could be set to make it work, if it's worth looking at. And then also this idea of comprehensive tax reform and bringing down the rate.

Dr. Bernstein. Let me start off with two comments that are supportive of what my pal Larry has been talking about. First of all, nobody is a criminal here. You are right about that. People are responding to incentives that are in the system.

But—and secondly, I am a strong—I am in strong agreement that the corporate tax code is quite a mess, and that doesn't help anybody. We sort of have the worst of all worlds. And the idea of a lower rate and a broader base makes sense to me.

Now that said, let me just cut to the chase of where I fundamentally disagree with where the conversation has been going for the last few minutes.

It is all supply-side trickle-down economics and it just doesn't work. I understand the motivation to give tax breaks to companies. And in fact, just to be clear, when you have revenue-neutral tax reform, which is what I think we are all talking about, there are winners and there are losers. So let's be clear about that.

Not everybody has a lower tax bill under revenue-neutral tax reform. And the idea that if you take the corporate rate down to 28, 25, 20, zero, that you are going to see growth bust out all over, has been disproved time and again by the historical record on precisely these kinds of ideas.

For example, right now even though the statutory rate is of course 35 percent, because of this morass of loopholes, and deferrals, and you name its, double-dutch Irish sandwiches, and inversions, the effective tax rate is probably about 10 points lower than that that corporations pay. And corporate profitability in recent quarters—it came down the last quarter because of the problematic GDP report—but in recent quarters, corporate profitability as a share of national income was at an all-time high in data going back to the late 1920s.

So if high corporate profitability led to faster job growth, we wouldn't be having many of the problems we are talking about right now. So absolutely clear out the tax code because it's the right thing to do, but don't expect to get these supply-side effects.

What you will get is a lot more corporate profitability. You won't see, necessarily, a lot more employment growth here. You might see it abroad. And you will get a much larger budget deficit, which is something I know Senator Lee is concerned about, as well.

Mr. Kudlow. I just, I just—

Vice Chair Klobuchar. Well—

Mr. Kudlow [continuing]. You have to ask yourself—okay, we disagree about this, I get that—why are all these other countries doing it around the world? You know, Europe is unfortunately suffering from a deflation. If their central bank would get going and put a little bit more money into the system, some liquidity, Europe could grow very rapidly. They did a good job, most of those countries, cutting tax.

Asia tax rates are lower than ours everywhere. Asia has recovered very, very nicely. Ditto for Australia. I don't agree with Jared that there's no incentive effect. I think there's a substantial incentive effect.

Vice Chair Klobuchar. Do you agree that we should pay for—you know, if we bring the rate down, which there's general consensus on—we may disagree on where—that we have to pay for it to keep the debt going down?

Vice Chair Klobuchar. You know, I'm very—I'm not very good on this debt stuff with respect to my friend, Senator Lee. To me, debt-to-GDP is the measure.

So if you grow the denominator faster than the numerator, you're fine. You're making an investment in the future. And that's where I come out on this.

Here's the—look at the system we have. Jared is right. Corporate tax collections are way below. We have so many loopholes. So what you've got here is a high rate and a huge loophole. That is called the wrong side of the Laffer Curve.

What you want is a low rate and ending the loopholes. You will collect vastly more revenues. Vastly more. And these firms will keep doing it, so they'll invest. It is not enough to have—you know, they've had a one-shot recovery in profits these recent years from the depths of 2008 and 2009, but they won't get a recurring—they won't get a recurring share of profits. Profits are already slowed down.

The 50 percent writeoff for equipment, which lapsed at the end of last year, is the reason corporate profits fell by 19 percent at an annual rate in the first quarter. Now that won't be repeated, but

many CEOs have said without that expensing they're not going to go into the investment game.

The trick is to make the profits work. And the only other point I want to make is this: Studies have shown that lower corporate rates, 70 percent go to the work force. 70 percent. There's a lot of work done on this by Keynesians, and supply siders, and what have you. It is really beneficial.

Vice Chair Klobuchar. All right, I can see Dr. Bernstein shaking his head, but I will leave it to Senator Lee since I have gone over my time. And if they aren't back yet from the votes, I will go back at it.

So, Senator Lee.

Senator Lee. I feel like Dr. Bernstein is going to explode unless I let him respond.

[Laughter.]

Vice Chair Klobuchar. Thank you, Senator Lee.

Dr. Bernstein. No, there has—I just wanted to point out that I think it is misleading to say that there has been “a lot of research that shows that corporate tax cuts redound to the benefits of labor.”

I can think of one or two papers, and I would just point out that as I recall, and I will check this—I think I'm right about it—that the CBO assumes half and half, not 70/30.

[Correction for the Record submitted to Chairman Brady from Dr. Bernstein appears in the Submissions for the Record on page 53.]

Mr. Kudlow. But half-and-half ain't bad.

[Laughter.]

Senator Lee. What if it is half-and-half?

Dr. Bernstein. That's my point. If you think that you're going to cut corporate taxes and get more revenue and generate more jobs and more income for middle-class households, just look back at the record of the past really 20 years.

Corporate tax payments as a share of GDP are close to the lowest they've ever been on record, while profitability is high. If corporate profitability led to jobs and income growth, believe me we would see it and I would have written a much different testimony.

I am sorry, but this magic elixir of cut taxes at the top and all of a sudden everything wonderful breaks out, has been disproved since Reagan. And yet people are still talking about the Laffer Curve.

Mr. Kudlow. But the revenue yield—of course the revenue yield goes down. That's the whole point of the need for reform. As I said earlier, you have a system of high tax rates and huge loopholes.

What you want is a system of low tax rates and no loopholes.

Dr. Bernstein. I agree with that.

Mr. Kudlow. Your revenue yield will be substantially higher. That is why I don't worry about, you know, revenue neutrality or the debt on this score.

Look it, Kennedy did it. It worked in the '60s. Reagan did it. It worked in the 1980s. Clinton kept it. In fact, I think Clinton had some expensing provisions in his second term that were very helpful.

It has worked. I disagree with Jared. When we went and let inflation dominate expensing and depreciation, it did work in the 1970s.

Senator Lee. Mr. Kudlow, I want you to tell us a little bit more about the importance of full expensing and cost of capital, and how those would lead to a stronger and fuller recovery.

Mr. Kudlow. Well, you know, corporate tax experts will tell you that you lower the cost of capital and you raise the return to investment. That's what you're doing. You want the cost of capital to be as low as possible, and the incentive effect then kicks in because you have a higher investment return.

Corporations don't pay taxes. They collect them, and then they redistribute them. Fred Smith, the CEO of FedEx, taught me this on the air one night on "The Kudlow Report" many years ago, and I have never forgotten the lesson.

I went back and I started reading the literature, because I am not a business tax expert. He's right.

Senator Lee. Okay, so—

Mr. Kudlow. They pass it on to the workers in the form of lower wages or benefits. They pass it on to consumers in the form of higher prices. And he said—and he's not alone; if you go into the Business Roundtable, all right, and talk to these CEOs—expensing is what they want. Alongside a lower rate, they want full cash expensing. That lowers the cost of capital.

Senator Lee. So regardless of what you think in the abstract about how graduated the income tax system should be on the individual side, in light of what you just said, I assume you take issue with Dr. Bernstein's suggestion that, to lower corporate tax rates would necessarily be equivalent to lowering tax rates on people at the top of the economy.

You would say those are two different things, and that tax rates on corporations should not be conflated, should not be regarded as the same thing as tax rates on individuals?

Mr. Kudlow. You know, ideally, ideally I would have a system where everybody pays about 15 percent. No deductions.

Senator Lee. Everybody? All individuals?

Mr. Kudlow. Everybody.

Senator Lee. And all corporations?

Mr. Kudlow. Yes, sir. Ideally. I would have a 15 percent flat tax for both businesses and individuals. And by the way, I would have individuals pay the dividends and capital gains that are passed through.

But let me make a point about the corporate tax, just to focus on this. I should have added this earlier. In my vision for this, the S corps, or the LLCs, can switch to the lower C corps rate. Now this is what happened in the 1986 tax reform. You've got a real, live example.

This is why all these inequality redistribution guys like Pochetti, this is what they always get wrong. They look at the numbers and say, oh, my God, look what's happened. The rich have gotten so much richer in the last 25 years.

The 1986 tax bill put the individual rate below the corporate rate. The individual rate dropped to 28 percent. The corporate rate stayed at 35. So what happened?

All these S corps and LLC passthroughs switched from the corporate rate to the individual rate and became S corps. So what that shows is a huge bulge in personal income which looked like a lot of inequality.

The fact is, gross income didn't change. It's just the way it was scored. I would do the same thing right now, because I think Main Street businesses have to be cared for. I think that's a big problem with our economy right now.

And when you combine federal, state, and local taxes, you know, in a lot of these large states, you're talking about a 45 percent, up to 50 percent, tax burden. So, yeah, I would let them switch into the lower rate.

Senator Lee. Just to be clear, I heard you say a few minutes ago that ideally you wouldn't have a corporate tax rate at all, but you're also saying ideally you would like to see a 15 percent rate applicable to all individuals and all corporations.

Tell me why you say that, first.

Mr. Kudlow. I, by the way, would abolish the corporate rate. I'd have some kind of net sales tax, net of all investment, and I would probably stick it at 15 so it would be the same as the individual rate. It's a flat tax. Essentially it's a flat tax. And I've advocated this for, I don't know, the better part of four decades. And I believe that would be—some countries have gone to a flat tax and they've had great success.

I think that would be the cleanest, simplest, and best pro-growth incentive structure we could possibly have. I mean, look, individuals—if 15 percent's the rate, millionaires are going to pay vastly more than people earning \$50,000 a year. It's actually very progressive. It's actually very progressive.

And I probably would do something to change the payroll tax rate, too, because I think middle-class people get really damaged by the payroll tax rate.

Senator Lee. And in some cases by the corporate rate, also. I mean, if what you're saying is true, if it translates to diminished wages, unemployment, and higher prices.

Mr. Kudlow. This is probably the part that is least well understood. Jared thinks it's half. I'll take half. I've seen studies that say 70 percent. But again, the principle, Senator Lee, that I'm proposing here is that corporations don't pay. They're collectors. They're just tax collectors.

The worker pays. The consumer pays. And that's why the yield to the Federal Government is so low. And whether it comes out of wages or benefits or both. Look, right now, right now—I'm stirring the pot some more—when you look at the current structure of our corporate tax, and you look at Obama Care, okay, which is, you know, setting tax penalties if you don't go into the system, you see these firms. What are they doing? They're pulling back on employment.

The part-time numbers are very substantial. Even last month, which was a great private—you know, 260,000 jobs. Well guess what? Full-time jobs last month fell by 523,000. Part-time jobs last month increased by 799,000.

I recommend to you the op ed piece in The Wall Street Journal a couple of days ago on this whole subject of part-time versus full-

time by Mort Zuckerman—I'm sorry, by my friend Mort Zuckerman. It's worth looking at.

This is a weird recovery. And part-time work is not good enough, because it doesn't pay as much. But that is where we're going because of Obama Care and because of high corporate taxes. It's a double hit.

Senator Klobuchar, you may not agree with me, I appreciate that, but that's my point of view. And you've got to give them some relief.

Senator Lee. Senator Klobuchar.

Vice Chair Klobuchar. Thanks. I want to change the subject a little bit here to the thing that I first raised, this part of this economic agenda, and that's work force training and immigration reform and those kinds of issues.

Dr. Bernstein, do you want to talk a little bit about that again? My State is not unique, as we see the unemployment rate going down, but it is in one of the top groups for having jobs that are unfilled because we simply don't have the skills right now with some of the workers. And ideas are—you know, Secretary Duncan has tons of ideas of bringing this more into the high schools, going into community colleges. We're doing a lot of that in Minnesota. Businesses are working to identify job openings in the next few years so we can get students trained.

But could you address that issue?

Dr. Bernstein. I will. If you'll forgive me, I need to make a few comments about this last exchange.

Vice Chair Klobuchar. Okay.

Dr. Bernstein. Look, this is a hearing about the recovery at five. And the target, in my view, and I think in Senator Klobuchar's view as well, is to reconnect this recovery to the livelihoods of middle income families, of poor families, the folks who have yet to be reached deeply enough by the recovery, is I think something that we all agree upon.

The idea that we would spend a considerable amount of time talking about how lowering the corporate tax rate is a solution to that problem strikes me as (a) fantastical, and (b) very unfortunate. We have a serious problem in this recovery that the growth that we've seen thus far has accumulated largely at the top of the scale, and it doesn't trickle down. It just doesn't happen, as much as we might like it.

So if we cut taxes at the top of the scale—and by the way, most corporate income does accrue to the top of the scale, and I have evidence of that from CBO that I would be happy to submit to the Committee.

If we think we're going to get here by supply-side tax cuts, I'm afraid we're going to (a) exacerbate the inequality problem; and (b) exacerbate the fiscal problems.

Okay. It is absolutely the case that the work force training of the very type you're talking to, and I know you've supported some of these ideas in Congress, are important in precisely the sense you mention.

Historically—and I've been around this track for awhile—our training was very indiscriminate, very nonsectoral in the sense that we sort of sprinkled some training on some people, show up

for work on time, and, you know, here are some basic skills, which I'm not degrading them but what's much more effective is when policymakers work with employers to figure out where the labor demand needs are going to be, where they're going to occur in cities like some that you've mentioned, Senator Klobuchar.

We know who these employers are, and we know the nature of their demands. They don't necessarily need someone who has a set of basic skills. I mean, that's fundamental. They need someone who on top of a set of basic skills knows how to clean an MRI machine; knows how to maintain a lab. So this kind of sectoral targeted granular training I think is very important.

Immigration reform is something I know that this Chamber, that the Senate anyway has passed a bill that I thought was a very useful one, mostly in the very terms you mentioned earlier in terms of its macro economic impacts.

That said, there are supply effects, and I think we have to be mindful about the pressure on low-wage workers from an increased supply of labor at a time when the economy isn't as strong as it should be.

So I think one of the things that actually helps immigration reform is a stronger economy, a stronger labor market.

Vice Chair Klobuchar. Mr. Kudlow.

Mr. Kudlow. Can I just say that, regarding work force training, at great risk I agree with everything Jared said.

[Laughter.]

Vice Chair Klobuchar. Excellent. I knew I'd find something.

Mr. Kudlow. Honestly. I think he's dead right. We have dozens of these—when I worked in OMB, I discovered we had dozens of these training programs. This was 30 years ago. And I don't know if any of them do anybody any good.

At the state level you have a much better shot at doing the match-up that Jared is describing, and I take it you support—

Vice Chair Klobuchar. Well that was in the recent Senate bill, the bipartisan bill that passed, that actually reduced a number of these programs to get more money out there in the field to the states, and I think is along those lines.

Mr. Kudlow. Yeah, I like that stuff. By the way, but you might save a buck by getting rid of a lot of the stuff. The Federal Government has probably got, what, 45, 50 of these programs, and somebody smarter than I am can comb through them and say "this doesn't work; it doesn't meet the criteria," for example, that Jared mentioned.

Vice Chair Klobuchar. And where do you see immigration reform fitting in here?

Mr. Kudlow. I am pro-immigration reform. All right? Sorry, but I am.

Vice Chair Klobuchar. I'm very proud of the bill we passed in the Senate, so I'm glad you are.

Mr. Kudlow. I may not agree with, you know, everything in the Senate bill, but generically. And let me say, I regard immigration reform as pro-growth. And I've written about this and, I don't know, Senator Lee, we may or may not agree on this, but look, I'm for border enforcement. I just want to put that aside for a minute. I'm not an expert on border—I'm all for border security, and I

think what's happening now is just an utter catastrophe, okay, and we've got to sort through that and probably deport all these kids.

But the growth aspect, which intrigues me, is to increase visas for the so-called STEM people. You know, science, technology, engineering, and math. I would almost have an unlimited visa supply. You go out to Silicon Valley here—not, here—in New York City, we have Silicon Alley, they'll all tell you there's a shortage. And a lot of them maybe trace to the education system or not, but there's a shortage. So that to me is pro-growth.

What's the study? I just saw it. 40 percent of the Fortune 500 companies are started by immigrants. And we also have tremendous deficit of startups, new, brand-new business startups.

Vice Chair Klobuchar. I think it's 90 of the Fortune 500 companies were formed by immigrants, and 200 were formed by immigrants or kids of immigrants.

Mr. Kudlow. Okay——

Vice Chair Klobuchar. I just wanted to take that opportunity.

Mr. Kudlow. Terrific. So we're at 290——

Vice Chair Klobuchar. I almost have as good a command of stats.

Mr. Kudlow. The bid is 290, the offer is 400.

[Laughter.]

We'll settle later. So I also think the kids who go to school should be allowed to stay. And again, I'm speaking about legal, but give them visas. Let them stay if they want to stay. If they love America and they want to help us, they're smart, we send them to the best private and public universities, let them stay. I'm all for that.

And at probably some risk I believe that the children who came here with illegals——

Vice Chair Klobuchar. The Dreamers.

Mr. Kudlow [continuing]. The Dreamers, should be allowed to dream. They should be able to take advantage. They should be legal, and they should be able to take advantage of our education system. I actually believe that. I think you have a lot of potential there that will help the country.

And I also would add, I would legally increase the visas and work permits for the low ends, for the growers and so forth. If you can get a job, you register in Mexico, let's say, register in Mexico, if an employer—you've got an E-Verify system—the employer will then say, yes, or no.

If it's yes, then you get a visa. And you have a guest worker program such as we have many, many years ago, the BRUSARA program. That stuff worked before everyone started interfering with it.

I don't think it's perfect. I know some people will violate it, but we've got technologies now that would help us. But, you know, I think the low end is also going to be pro-growth. And most of all I don't see this as a zero sum game.

In other words, if high-end immigrants, low-end immigrants come here legally, I do not believe that means our people lose wages or jobs. I want to grow the pie larger. And I think too many people think in terms of a zero sum game on immigration and I don't believe it.

Vice Chair Klobuchar. All right. One last thing I have, and I'll turn it back to Senator Lee.

Dr. Bernstein, at the beginning of this session you were talking about how we need to focus very strongly on the income inequality issue, and I agree with that. I want you to know, I may not have started out with the cookie-cutter Democratic questions when I asked Mr. Kudlow about the inversion issue and the incentives in place. We're just living it right now in Minnesota.

And luckily for us, we have a good company that I believe is going to keep jobs and expand jobs in our State. But that's not been true of all of these proposals that are out there. And I think it is an immediate issue because we are just seeing more and more companies do this, and we have been frustrated so long in getting comprehensive tax reform, and even I've been generally supportive of the Gang of Six, Gang of Eight. This is the only place in the country where gangs are good things. But, you know, the work that is being done on bringing the debt down.

But I think you know, Dr. Bernstein, that those proposals also included some revenue in there and some expenditures in areas like NIH and other things. And I just ask you to go back to that general issue you raised of income inequality.

We had Secretary Reich in here who went through the numbers with us. I think it's the top one percent families have grown seven times more in their incomes than the average family, and we are just starting to see more and more of a problem.

And one of my favorite CEOs in Minnesota—I have to get permission to say who they are—was saying recently that they believe that we are actually eating into our economy and our profits because a lot of what is happening is middle class people that used to go to middle class restaurants, or stay in middle class hotels, aren't able to do that because they can't afford it.

And I don't believe it is just one solution on the minimum wage. I believe it's everything we've been talking about, with making sure we have the incentives in place for companies to stay here. Immigration reform. Inventing more things. Making stuff. Exporting to the world. Making sure those barriers aren't up. And then also looking at the work force training, and student loans, and it's got to be a lot of things. But I wonder if you would just address the minimum wage issue?

Dr. Bernstein. I will. Let me reference a couple of other things that you ticked by there in your list of everything good.

I would like to say that I think this—I would just like to get on the record, and I suspect Larry will agree with me—I don't think that a solution to inversions, which we may argue about what that means, can wait for tax reform, can wait for individual tax reform, can wait for corporate tax reform. I would urge Members of this body to start working on that yesterday.

Let me tie the inequality discussion into what we've been talking about in terms of the recovery at five in a way that I think will resonate perhaps with Members from the other side, as well. And I will mention the minimum wage towards the end of my comments.

One of the most effective tools against rising income, wage/wealth inequality is actually a full-employment economy, a full-employment job market. I have done extensive research on this, often in collaboration with the economist Dean Baker. We have a recent

book on this topic. Wherein we point out that if you look over the period say mid-'40s to late '70s, when inequality was relatively quiescent, the job market was at full employment, about 70 percent of the time.

Since then, it has been at full employment only about 30 percent of the time. And we show that when the economy is operating with this much slack in the labor market, the cost to that problem redounds to low income people the most, middle income people next, and it doesn't really hurt those at the high end because their unemployment rates are fractional at good times and at bad times.

In fact, a 10 percent decline in the unemployment rate—so not percentage points; 10 percent—say down from 7 percent to 6.3 percent, leads to, in our analysis, a real 10 percent gain at the 20th—for low wages, a real 10 percent gain for low wages; 4 percent gain for middle wages; and zero at the top.

So it's actually very much an antidote to the problems of an employee of course working the other way. Depressing gains at the bottom, and accentuating gains at the top.

Now added to that, a moderate increase in the minimum wage has been found to have its intended effects, which is to list the earnings of those at the bottom of the wage scale without anything like the very large displacement effects that opponents claim.

Now these are the workers with the least bargaining power, particularly in a climate of high unemployment. And even when the job market is pretty tight, it's often weak for those at the low end, particularly for minority workers. So a minimum wage is Congress's way of returning some bargaining power and a bit of the growth to the lower end of the pay scale.

Recent analysis by the Congressional Budget Office of a policy that's been introduced in both the Senate and the House, I believe, by Senator Harkin and Congressman Miller, find that a three-year incremental increase that would take the minimum wage to \$10.10 an hour, and then index it, would lead to 24.5 million people, 24.5 million workers, benefitting from the increase, 500,000 jobs lost.

That's a ratio of 49 beneficiaries to 1. And I think it's a very strong deal. Now I don't think those 500,000 who CBO says jobs lost are to be ignored, but I will mention again 49 to 1 beneficiaries, and there's a great deal of churning in the low-wage labor market. When they get a new job, it will be a better job.

Vice Chair Klobuchar. Thank you, very much, Senator Lee.

Senator Lee. Mr. Kudlow, do you want to respond to that?

Mr. Kudlow. Yeah. I'm sorry, I completely oppose a hike in the minimum wage. I think it really damages people at the low end. It damages the poorest, the least educated. I think that, you know, Jared's point about income, sure, what you get is a rebasing, a higher rebasing. Let's say you're in a Union state or just the middle of the job ladder. All their wages go up as a result of the rise in minimum wage. So it helps those who already have jobs, and hurts those who don't have jobs, and will hurt those who have marginal jobs.

I commend to you a book by my friend, Jason Riley, The Wall Street Journal editorial page. It's a book about African American economic discussions. And he points out that for many, many, many decades African Americans had the same unemployment rate

as White Americans did. And since the inception of the minimum wage, which was four or five decades ago, African American unemployment is now double White unemployment and stayed there. It stayed there for about 50 years.

And I think that the evils of the minimum wage are even understated by the CBO's analysis, which is a job loss analysis.

You know, I would say this. I'll concede one point on this. If states want to do this, because they are closer to the businesses, and if your CEOs in Minnesota want a higher minimum wage, okay. At least the Tenth Amendment would have federalism, they know more about it than the Federal Government. I say at the federal level, the government has no business telling companies what they ought to pay their employees—no business whatsoever.

Senator Lee. Thank you, Mr. Kudlow.

Chairman Brady [presiding]. Thank you, Senator, for chairing the hearing today, and I apologize again for the timing of the vote on this.

I know a number of questions have been asked about the priorities of fixing this broken tax code, the lowering of our rates, becoming more competitive. And I believe, too, you know, our ability to rapidly recover our capital, reinvest it back into these investments, will continue to be a strong part of our tax reform.

Since that has already been explored quite a ways, Mr. Kudlow, let me ask you. I have a question about the Fed policy, and a question for Dr. Bernstein about regulation.

Mr. Kudlow, the Federal Reserve plays an important role in laying the economic foundation for any country. The Fed often tries to do, in my view, too much. And in fact, their tools can only boost employment in the short term.

In the long term, their tools are best used addressing inflation and deflation, which create I think a strong foundation for economic growth.

Looking at the last five years since the recovery began, looking forward, your advice on the best monetary policy that would allow us to close that Growth Gap, frankly, and create a better foundation for economic growth?

Mr. Kudlow. All I ask from the Fed is that the prices are stable. Inflation is as low as possible. And the currency is strong and reliable. That's all I ask.

I go back 50 years ago in 1968 in his Presidential address to the Economics Association, American Economics Association, Milton Friedman gave this talk. And I encourage everyone to read it. It's one of the reasons he got a Nobel Prize.

And you talk about limits? You are right. Monetary policy has no lasting impact on employment, on investment, on all the real variables. Monetary policy has direct long-term impacts on inflation, and hence interest rates and the exchange rate.

So I come out in favor of rules. I'm a rules-based guy. I like to have fiscal rules. I like to have monetary rules. And I would just offer two suggestions: Number one, the Taylor Rule, which I think would be quite useful, and was used predominantly—predominantly, central banks all around the world used the Taylor Rule in the 1980s and 1990s. It wasn't just us.

By the 1990s, that was basically the view. And as you know, that is the formula that combines potential GDP and inflation.

I would also, Mr. Chairman, I'd like forward indicators, forward indicators. That's why I'm a stickler for using so-called market price rules. I think central bankers ought to keep an eye on gold. They ought to keep an eye on commodities. They ought to keep an eye on the Treasury Yield Curve. And they ought to keep an eye on the exchange rate.

Those are pretty good forward indicators. Probably none of them alone is perfect. If you use the four of them, you pretty much cover the ground. So that is where I would go.

The other thing is, as I said on fiscal policy, I don't think the federal stimulus works. I don't believe there were multipliers. The same with the Federal Reserve. They bought over \$3 trillion worth of paper. The money multiplier brought—the difference between the monetary base and the money supply collapsed. The multiplier collapsed. And, by the way, so did the turnover of velocity of money.

The money supply itself hasn't changed in five years. The good news is, there's no inflation. The good news is, there's no inflation. The bad news is, the Fed has embarked on this, you know, vast journey that they're now going to spend the next five years trying to get out of.

I also believe it's a huge mistake—I'll end on this point—with all due respect to Ms. Yellen, it was very, very smart. This business of using a group of labor indicators to conduct monetary policy is dead wrong. It's a reversion back to the old Phillips Curve tradeoff, which I think has no validity. Her dashboard of indicators I think is just absolutely the wrong way to go.

Chairman Brady. We are told often in this hearing room, don't worry about inflation. It isn't here. It won't occur. We need to focus on getting people back to work.

But inflation isn't always so clear and can take root long before the Fed, frankly, can identify it. And the Fed, frankly, is honest about its limits there.

For the sake of caution, should the Fed begin now, or soon, normalizing interest rates? Again, working off not over a decade but begin normalizing its policy sooner rather than later? Do you think that can be achieved without a negative impact on the economic growth going forward?

Mr. Kudlow. Well, hope springs eternal. Hope springs eternal. I think the answer is theoretically yes, you can do it. And I think what they want to do—it's just my take—they're going to let the bond portfolio basically run off. There's not going to be massive selling of bonds. And given the situation they're in, I basically agree with that. I grew up as a Fed guy, and I was a Fed watcher, and I was a bond economist.

If I owned \$4 trillion worth of paper, I'd let it run off, too. If they keep selling it to the market, that's going to be really, really tough.

Other ideas they have, I don't know, sir. Paying interest on reserves, we don't have a lot of experience on that. Manipulating the so-called reverse RP market, the MATs, we used to call MATs, sale purchases, basically means the private sector loans money to the Fed at a certain rate. We'll have to see.

Yes, let's start normalizing. The Taylor Rule right now, just as a reference point, the Taylor rule right now would have the Fed Funds Rate at not less than 1.5 percent, possibly higher. All right? I wouldn't do it tomorrow, but I would pave the way.

And what troubles me a little bit—and from what I caught a glimpse of Ms. Yellen's testimony this morning—I don't think the Fed is paving the way. I think their forward guidance is murky.

Chairman Brady. Murky.

Mr. Kudlow. Murky. And one of the really good things here is the stock market has done very well. A lot of people would say the only people that benefitted was the top one percent. I want to disagree with that.

I want to remind everybody, if I may, that roughly 50 percent of American households one way or another are invested in the stock market. And that means pension funds. And that means school teachers, and cops, and firemen and women, okay, as well as millionaires.

And let's not blow—let's try hard not to blow off the stock market. Let's really try hard. It's as, as I think Jared said, or somebody said, it's contributed to a lot of gains in household wealth, and the distribution is not bad. And I want those pension funds to heal. Otherwise, the states are all going to go bankrupt.

So my point is, I would like to see the Fed start paving the way, and they're not.

Chairman Brady. Thank you, Mr. Kudlow.

Dr. Bernstein, I need to recognize Ms. Maloney, who has not asked a question, but perhaps with your permission I could come back for a final quick point. I don't want to take too much time.

Vice Chair Klobuchar. Mr. Chairman, we now have votes in the Senate, so I want to thank the witnesses for their patience with this revolving chair game.

Chairman Brady. Thank you, Vice Chair.

Vice Chair Klobuchar. They did a great job, and it was a lot of fun. So thank you. We learned a lot, and hope to have you back soon.

And thank you, Mr. Chairman, for holding the hearing.

Dr. Bernstein. Thank you.

Chairman Brady. I recognize the former Chair of the Joint Economic Committee, Ms. Maloney, from New York.

Representative Maloney. Thank you, Mr. Chairman, and Senator, for calling this meeting. It is very good to see both of you again. Mr. Kudlow happens to be a neighbor of mine, so we see each other back in the District I am privileged to represent.

I would like to first start with Dr. Bernstein and get your input, too, Mr. Kudlow.

In your testimony, you testified, and I think it was your sixth frame you used in your opening statement, you testified that austerity, and many of the self-inflicted wounds that we put on ourselves such as the government shutdown, sequestration, not paying our bills, that this—indiscriminate cuts to key government programs—that they're hurting the economy and harming our long-term competitiveness.

For example, funding cuts to the National Institutes of Health are damaging critical research efforts. And I would say, not fund-

ing the Highway Trust Fund in the long range hurts planning and business. I would say this debate mystifies me over the ExIm Bank. It is making money now, and helping small and large businesses export, which is one of the areas that we need to work on.

And I would say the failure to reach an agreement on TRIA for long-range planning are all damaging to our economy. So in your opinion, how can we achieve a balanced budget while still investing in things that will help our economy in the long term? And how damaging do you think were self-inflicted wounds like sequestration, and closing the government down, and cutting NIH and others indiscriminately?

Dr. Bernstein. Well thank you for your question. One of the things I wrote about at a bit of length in my written testimony, which I submit to the Committee, is precisely this question. And I went to some lengths not to cite my own work, not to cite the work of the White House or anyone who could be accused of having a thumb on the scale.

I cited the work of mostly investment banks, or the Congressional Budget Office. And every one of those analysts found that the events that you mentioned created a negative impact on GDP growth and on jobs.

As you mentioned, one of my figures—which happened to be by Goldman Sachs researchers, so we’re not talking about wild-eyed radicals here—one of my figures quantifies the impact of the federal fiscal policy on real GDP, showing quite clearly, by the way if you want to go back a few years, some of the positive fiscal impacts of measures I touted in my testimony back in the heart of the Great Recession. But that those—there it is—

(Slide is shown.)

—that those reverse course. 2013 was a particularly tough year wherein fiscal drag, including self-inflicted wounds of the type you mentioned, subtracted 1½ points off of GDP growth this year.

I have never heard, and I don’t think anyone could come up with a particularly good explanation, as to why public policy ought to slow down a recovery that is still trying to gain traction there in 2013.

So I think that the implicit points of your question are exactly correct. I didn’t get a chance yet to weigh in on the ExIm Bank, so let me do that quickly.

My view is that the role of the bank is important, and it should be mended not ended.

Private banks will demand a very high premium to offset the risk involved when it comes to loans to those who would purchase our exports, to overseas’ buyers of our exports. And this extra cost could kill the deals for some of our smaller and less well-capitalized firms who are trying to boost their exports.

As you mentioned, the fact that the ExIm Bank is a small net plus for the budget tells you that the risk assessment is actually pretty effective in this regard.

Now it is the case that, while most of their loans go to smaller businesses, most of the dollar value—volume of their work helps large firms who arguably don’t need the help. So I think there is room for certainly reform and improvement there. But as long as our competitors, our international competitors are providing credit

assistance to those who purchase their exports, I simply don't see why we would consider unilaterally disarming, especially at this point in time.

Representative Maloney. Thank you.

Mr. Kudlow.

Mr. Kudlow. Yeah. I'm afraid I disagree on that one. I would not reauthorize the ExIm Bank. I think it's just a beautiful, perfect case, a real-world case of corporate welfare and cronyism. And, let's see, something like 60 or 65 percent of the money goes to 10 companies.

And we are giving a lot of loans and loan guarantees to countries that are not our friends. I would add, we give about \$2 billion to Russia. I wouldn't give them a nickel. We give close to \$10 billion to Saudi Arabia, an outfit that finances terrorism more often than not.

Here's one for you. They give \$2 billion—they have given \$2 billion worth to Venezuela, a communist country. They hate us. Why are we doing this?

Also, as Jared put his finger on another point, by financing foreign competitors we're doing some damage to ourselves. This is what the CEO of Delta keeps saying. He's a very brave man. He has actually come to the point where he's said: You know, if you stop making these loans to Boeing's customers, I'd be able to hire more workers and my cost of capital would be more competitive, and I would be able to buy more jets from Boeing.

So I think that we've just gone way too far. We do not need the ExIm Bank; 98 percent of these transactions—

Representative Maloney. But, Mr. Kudlow, if they did not buy Boeing, they'd be buying Air Train. And now China is coming out with their competitor to Boeing, and these are heavily subsidized by the countries that produce them.

Mr. Kudlow. You know, we might generate a stronger airline-making business—I mean, you've got Lockheed, you've got a bunch of 'em—so we don't necessarily—look, on the government dole. I don't think these companies need to be on the government dole.

I think the information in the last month shows corruption inside the ExIm Bank. You've got a bunch of people now that are being criminally investigated for taking bribes and other forms of fraud.

You've got an even larger number of people whose cases have been referred to the Justice Department. I mean, what goes on there—

Representative Maloney. Well that's good that we're finding the fraud, but my time is running out. Could you comment, too, on some of the self-inflicted wounds to our economy such as sequestration, such as closing the government down, such as the instability? You talk all the time about businesses need long-term planning, they need certainty.

So when you're renewing programs for seven months, or six months, and not renewing them long term, it has a disruptive effect on the economy.

Can you comment on some of the self-inflicted wounds, I would say, that we are—most economists feel that the government shutdown was not helpful to the economy, nor was sequestration, nor was cutting some of the vital areas that we invest in for our com-

petitiveness such as the National Institutes of Health and other research facilities, cuts in those areas.

And then renewing the Highway Trust Fund just for a couple of months, as opposed to a long-term range? The impact of these policies on our economy.

Mr. Kudlow. Well renewing the Highway Trust Fund for a couple of months is not a great idea. I would have a radical overhaul of the Highway Trust Fund, by the way. I think it should all be based on true user fees based on mileage. I would not raise the gas tax. I'd abolish the gasoline tax. I would turn it into a user fee operation, with the bulk of it being run by states. That's the way I would do that.

Secondly, shutting the government down is not my favorite thing in the world. Okay? So I'm with you on that one. Sequestration was not my favorite thing in the world, either. However, however, as I've testified earlier, even though there are some priorities that got lost in sequestration, the CBO and others predicted hundreds of thousands of lost jobs, 700,000 lost jobs. It never happened. Jobs went up by a couple million in 2013.

The horror shows never happened. And I believe limiting government spending is itself a pro-growth measure, though I would not—I would have preferred not to use sequestration.

One of the achievements here—I know you'll disagree with me—but my view is, getting government spending down from close to 25 percent of GDP four or five years ago to less than 21 percent of GDP is a good thing, a very good thing. And it gives the private sector a lot more room to breathe, and takes the pressure off tax hikes that many businesses think they're going to have.

So I might not have done it that way. I happen to be in favor of some NIH spending. I'm also concerned about our defense posture which I think suffered enormously under sequestration. But sometimes you have to bite the bullet. We've had Gramm-Rudman in the past when I worked down here. We had budget freezes during the Reagan years. There was a lot of howling. I think on the whole limited government is a good thing. It's pro-growth.

Representative Maloney. Dr. Bernstein.

Dr. Bernstein. Can I quickly respond to some of that? A couple of times Larry has mentioned something that I disagree with, which is this idea that somehow because we had job growth last year all the self-inflicted wounds really didn't do any harm.

That is just substantively an incorrect analysis. It is not an accident that in 2013 when we were creating significant fiscal drag, which many of the analysts I cite in my testimony quantify to 1½ percent of GDP, which is a big deal, that job growth was considerably slower last year than it is this year.

And in fact I commend Congress for moving to a kind of a do-harm in terms of fiscal headwinds, to at least a do-no-harm neutral view. If you look at my slide No. 6, you will see that this kind of fiscal impulse is neutral in 2014 relative to negative in 2013.

So the fact that there was job creation in 2013 is not at all an argument that this stuff didn't hurt. And in fact, the fact that there's been acceleration in job creation this year, something Larry agrees with, is further proof of my case I think.

Mr. Kudlow. You know, as I said before, again with all respect to my friend Jared, Congresswoman, you know this, I don't believe in federal spending stimulus. I don't believe in federal spending multipliers. I don't. I don't think that's the path to economic growth. I'm not a spender. Never have been; never will be.

I believe in the incentive model of growth. And I think if it pays after tax to work, invest, and take risks, and I include regulatory costs in that calculation, it's not just a tax issue, then people will do so.

Dr. Bernstein. So let me just say——

Mr. Kudlow. I think we've had——

Dr. Bernstein. Sorry, finish.

Mr. Kudlow. I believe in the last 10 years, dozen years, we've had too much government activism. And I don't know the answer to this, but if you go back and you look at just data, I think since 2001 or 2002, if you take the so-called Bush recovery and you take the Obama recovery, the rate of growth of real GDP in the USA has averaged only 1.8 percent per year—under Bush and Obama. That's terrible.

Now it just seems like 9/11 was—something happened. I can never—if I was smart enough, I'd write a book on it. All I know is, we were growing in the 1980s and 1990s with tremendous prosperity under Democrats and Republicans. We were growing about 3.5 percent a year, creating new wealth, new technologies, new businesses, like no tomorrow. It was fabulous.

And all of a sudden it stopped, under Dems and under Republicans, under different Congresses. I'm completely nonpartisan in this.

Representative Maloney. 9/11 changed our country profoundly.

Mr. Kudlow. Carolyn, you may be right. I mean, I just don't know all that there is to know. I just put that fact on the table. And I personally—look, I'm an old guy. I want everything to be better in the country.

Something's gone wrong. That's what I know.

Dr. Bernstein. So all I wanted—can I add something, sir?

Chairman Brady. Quickly.

Dr. Bernstein. Very quickly.

Chairman Brady. We're about 20 minutes overtime——

Representative Maloney. This is great, though.

Chairman Brady [continuing]. Yes, briefly.

Dr. Bernstein. I think you'll——

Representative Maloney. I've got one last question.

Dr. Bernstein. I think you'll like this. I think you'll like this—you, as well.

[Laughter.]

The idea that I am trying to espouse here in terms of Congressional actions to help improve the recovery and to offset the damage done by the recession are not ideas that I think should be in place when we have an economy that's firing on all cylinders.

If we're at full employment, I believe that fiscal policy should be towards lower deficits, and lower debt-to-GDP ratios.

Where I differ from Larry is he always thinks that fiscal multipliers are zero. There are absolutely times when fiscal multipliers are zero, and when none of these good Keynesian ideas work.

That happens to be not the case when the economy is demand-constrained. When the economy is demand-constrained, these ideas are actually very important.

Chairman Brady. I'm going to blow the whistle here. That 5-minute period is now close to 15. So, Representative Maloney, thank you for your questioning.

Let me finish up with a question for Dr. Bernstein. I too disagree that government spending is a solution. For the past six years, we've overspent our budget by nearly \$6 trillion. The result is the weakest economic recovery in half a century.

Doing more of that I don't believe will change the course of our economy. Looking over the last five years, consumer spending recovered quite some time ago. It's up beyond what it was before the recession.

Government spending recovered fairly quickly as well, due again to that stimulus, well above the recession. What continues to be missing is business investment, building, equipment, software, one of the one-to-one correspondent with private sector jobs.

Your view? And when I talk to local businesses, national businesses, multi-national businesses, they don't talk about sequester. They don't talk about the government shutdown. They talk about fear of higher taxes. In fact, the San Francisco Fed said the biggest fiscal drag in 2013 was not sequester; it was higher taxes.

The question is—and they don't talk about those issues, inside-the-beltway issues—they talk about the potential of higher taxes and tremendous regulation. My question to you is: Is there a smarter way to impose regulations that have public good, frankly, to them, but are done in a way without economic analysis, without understanding the technology available to reach those goals, done in a way that is smarter and helps grow the economy, is there a way in your view that when regulations are imposed in an Act they can be done in a way that is smarter for the economy?

Dr. Bernstein. That's a great question, and a challenging one. One quick factual point. It is true that part of that fiscal drag that I've been complaining about in 2013, was due to a tax increase. And that was the expiration of the payroll tax holiday, something I think was a mistake. I think that's precisely in the spirit of what I'm talking about in terms of helping to boost the recovery.

To get to your question, I think there are two things that come to mind. And it's such an important and challenging question, I'd like to submit an answer following.

Chairman Brady. Thank you.

Dr. Bernstein. So two things come to mind.

First of all, I think we need a better method of evaluating the regulations that we put forth. Any time a regulation is suggested, say an environmental regulation, both sides go into very predictable corners. I could write the press release from both teams. One says it's going to crash the economy; one says it's not.

In fact, the truth of course always lies somewhere in between. But I think where the argument gets weighted in a way that is actually harmful to longer term growth is that we almost never consider the benefit side of any regulation.

So for example, environmentally, I mean most businesses will tell you that climate change, more volatile weather, unpredict-

ability of the environmental impacts, rising water levels particularly for businesses in any coastal area, are extremely problematic. But often our regulatory analysis only looks at the costs, not the benefits. So I would balance that out.

My second point gets to something you said earlier. I know you think a lot about the Federal Reserve and ways in which they can operate to help the economy more effectively. Well if you actually look at the last three business cycles, they ended because a financial bubble inflated. A real estate bubble. A dot.com bubble. And a housing bubble.

And part of that has to do with insufficient oversight of the Federal Reserve toward financial markets. Former Fed Reserve Chair said we don't really look at bubbles. That's not our thing. We can only try to mop up the damage afterwards.

To her credit, Chair Yellen and now Vice Chair Fisher feel differently about that, and have expressed the views that—have recognized how important financial regulation, financial oversight, is so that we can prevent the next business cycle, the very one we're in, from inflating another damaging bubble.

Chairman Brady. Just a thought, my view, that wasn't simply a housing bubble. It was a credit-fueled housing bubble.

Dr. Bernstein. I agree.

Chairman Brady. The Federal Reserve kept interest rates too low for too long. The Federal Government was encouraging banks and its own Fannie and Freddie to buy, frankly, and invest in mortgages that didn't have true value underlying them. And combined with a lot of other factors, were part of it.

Here's my point, and I'll finish up on regulation. If you took a look at the last 10 years of federal regulation, out of every 1,000 federal regulations only 3 had a cost/benefit analysis done prior to its imposition.

So in only 3 out of 1,000 did we ask the simple question: What are the benefits? What is the economic cost? And part of that—and when it was done, it was done by the same agency proposing the regulation. So agency bias, as you would imagine, ended up in a result that, hey, we think this is a good regulation.

It's my view that we would be smarter about our regulatory scheme if all agencies, not just Executive and independent agencies, including the Fed, had to do real cost/benefit analysis ahead of a regulation that was transparent. You could see what the factors were going into that before these were imposed.

Because I think there is a way to hit those goals, but to do it in a much smarter way with much less cost to the economy. I think it is one of the major drags today.

Mr. Kudlow. Where's OIRA?

Chairman Brady. What's that?

Mr. Kudlow. Where is OIRA?

Chairman Brady. It is due—

Mr. Kudlow. It started in the Reagan years, mandated by Congress. Isn't that supposed to do that?

Chairman Brady. It should, but I noticed out of the 3,500 federal regulations year-before-last, only 14 underwent a true cost/benefit analysis. So I think there's actually a bipartisan area of agreement that could be explored in that area.

Representative Maloney. And I would like to help the Chairman on this. I find this fascinating, the give-and-take between these two economists. May I ask another question that is raging before Congress right now?

Chairman Brady. If we can do it in a minute.

Representative Maloney. One minute. Okay, one of the disagreements we've had between the two Parties was over extending unemployment insurance, because of the high number of people that were unemployed.

Now last month's job numbers were wonderful, the best stock market—you mentioned the stock market, Mr. Kudlow, 17,000, best in history. And unemployment was down. And for the first time it was because workers are there, not that people have stopped looking for work.

Now both sides are claiming credit. The Democrats on the programs and policies that President Obama put forward; and the Republicans are claiming credit that we did not extend the unemployment benefits, therefore we saved money that contributed to this economic growth.

Yet many economists are saying that if we had extended long-term unemployment benefits to those people that were truly trying to find a job, that our economy would have strengthened.

What is your position between these two? And this is something that commentators are writing about right now, conservative and liberal, on opposing sides. I would like to hear, if we could, both of these distinguished guests.

Dr. Bernstein. I can be very brief, which I know you would like. As we've noted, the share of the labor force that's long-term unemployed has come down significantly. And that's a good thing.

But it is still highly elevated. And every time this metric, the share of the unemployed who are long term has been this high, as high as it is now, even with its improvement, Congress has implemented another round of extended unemployment compensation, emergency unemployment compensation.

So I think it is absolutely warranted, another round. But I think you have to watch the indicators to see when they get back down to more normal levels.

Representative Maloney. Mr. Kudlow.

Mr. Kudlow. Just briefly, I think extending the emergency unemployment insurance would discourage growth and would discourage jobs. And I would lead that to—

Representative Maloney. Why?

Mr. Kudlow. Because you're reaching a point now with food stamps, disability, unemployment insurance, as I mentioned in earlier testimony, Professor Casey Mulligan of Chicago did the work on this, you're creating incentives not to work.

And in fact, the really hard part is, if you leave food stamps, leave unemployment, leave disability, it doesn't pay. You lose your subsidy and you're in a higher marginal tax rate. The cliff is so steep with these programs—

Chairman Brady. A significantly higher tax rate.

Mr. Kudlow. It could be as much as 90, 80, 90 percent. And by the way, the CBO has done work on this, too. In fact, it was Casey Mulligan who turned the CBO around on some of this.

All I'm saying is, as a safety net matter I would agree with Jared. Extend unemployment insurance, as a safety net matter. But we're five years plus into this recovery. So I don't believe that safety net is anything but a discouragement to searching for good jobs. And if—you know, if our state wants it, let the state do it. I would push this to the lowest level.

By the way, it doesn't come cheap. You've got to pay a higher payroll tax at the state level.

Chairman Brady. I want to thank you both for being here. There's a reason you were invited. We wanted this type of quality discussion, frankly. We think there ought to be more of this type of discussion in Washington among lawmakers. Thank you for your insight.

I know Members may have some questions they'll submit to you for the future, but again thank you both, Dr. Bernstein, Mr. Kudlow, for being here today.

The hearing is adjourned.

(Whereupon, at 3:47 p.m., Tuesday, July 15, 2014, the hearing in the above-entitled matter was adjourned.)

SUBMISSIONS FOR THE RECORD



Joint Economic Committee

Representative Kevin Brady • Chairman

CHAIRMAN KEVIN BRADY

JOINT ECONOMIC COMMITTEE

JULY 15, 2014

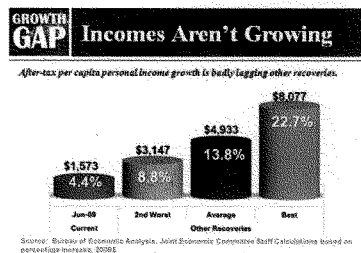
The Obama Economic Recovery at Five Years: An Assessment

Vice Chair Klobuchar, Members, and distinguished witnesses:

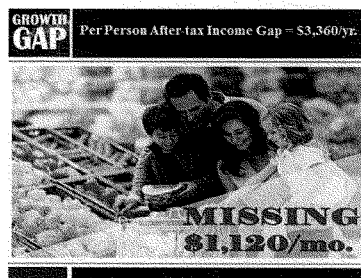
This June President Obama's economic recovery turned five years old. Despite a near trillion dollar fiscal stimulus package, \$5.8 trillion in federal deficit spending, and a massive ongoing stimulus by the Federal Reserve, this recovery—while economic conditions have improved—is disappointing by all measures.

We all hope America gets back to work, but honestly it's difficult to find a metric on which the Obama recovery rates favorably. Wall Street is roaring, but Main Street and middle-class families are being left behind.

For most Americans, income growth has flat-lined. Since the recession officially ended, real after-tax income has edged up by only 4.4 percent a person—that's less than a third of the average recovery (13.8 percent) of the past half-century.



For middle-class Americans, this means that a family of four is missing \$1,120 from their monthly budget—they are, in effect, missing the equivalent of their monthly rent or mortgage payment. Since the recession ended those missing dollars exceed a whopping \$40,000 for that family. Can you imagine how many groceries, gasoline, and utility bills that would pay for? No wonder so many Americans feel like the recession has never ended for them.



So far, due to President Obama's Growth Gap, our economy is missing \$1.6 trillion in real GDP compared with the average of other recoveries since 1960 (and \$2.2 trillion compared with the Reagan recovery).

This means America's economy is missing an economy larger than that of Australia, Spain, or Mexico. If we don't begin successfully closing this dangerous Growth Gap, our nation's economic hole will soon be larger than the entire economy of neighboring Canada.

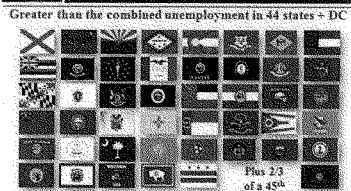
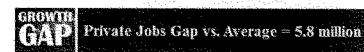
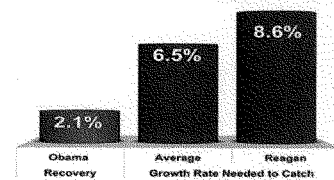
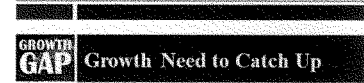
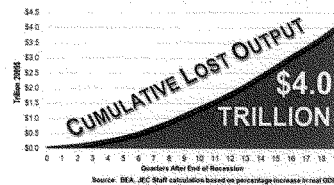
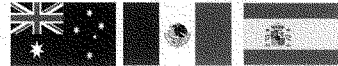
Cumulatively, the overall loss in economic output in America is \$4 trillion compared with an average post-1960's recovery. That gap alone would qualify as the fourth largest economy on the planet. Can you imagine how much that missing economic growth would help American families today?

Can President Obama catch up? Can his economic leadership close the Growth Gap? We hope so, but it will be difficult. Just to qualify as the leader of an average, C-grade economic recovery by the end of his presidency, real GDP will need to grow at an annual rate of 6.5 percent during each and every quarter. Unfortunately, the U.S. economy has only topped a 4 percent annual growth rate in two quarters of this recovery.

Disappointing economic growth means jobs are missing too. Despite 52 consecutive months of private sector job growth cited by Dr. Bernstein, the U.S. economy still suffers from a private sector jobs gap of 5.8 million measured from the end of the recession. These are Main Street jobs, not government jobs. And to put this staggering jobs gap in perspective, closing it would mean that every person searching today for a job in 44 states and the District of Columbia could go back to work.



Greater than the size of the
Australian, Mexican, or Spanish
economies



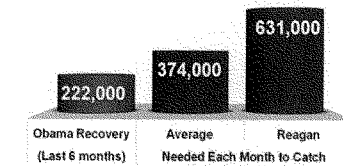
Eliminating the jobs gap won't be easy, either, for the President. The U.S. economy would need to generate an additional 374,000 private sector jobs each and every month for the remainder of the Obama presidency. Unfortunately the White House hasn't achieved that even once during this recovery, and has broken the 300,000 private sector jobs per month mark only twice.

While we all cheer the lower unemployment rate, unfortunately the decline is largely a mirage created by American workers leaving the workforce. Without the fall in the labor force participation rate to 62.8 percent since President Obama took office—a multi-decade low last seen when Jimmy Carter was in the White House—the unemployment rate would actually be 10.2 percent today, not 6.1 percent.

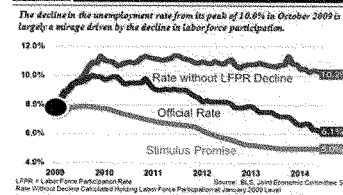
Those dropping out of the work force aren't the elderly taking early retirement—their participation rate has actually increased since 2007. It's the 16-59 year olds, both the young and prime working-age individuals, whose participation has dropped. As a result, our labor force is missing more than 3.4 million workers between the ages of 20 and 59.

To the President's credit, from the end of the recession through April, total employment has increased 5.7 million. Unfortunately, over 11.3 million Americans have been added to the food stamp rolls during the same period. This is not a hallmark of a strong, broadly based recovery.

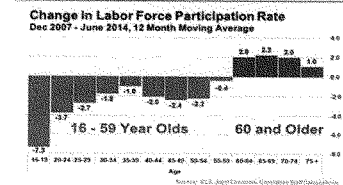
GROWTH GAP Needed to Eliminate Private Sector Jobs Gap



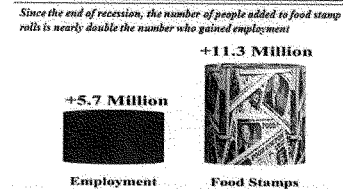
GROWTH GAP Unemployment Rate Mirage



GROWTH GAP Only Older Americans Have Higher Participation Rates



GROWTH GAP Not a Sign of a Strong Recovery



Are recessions caused by a financial crisis difficult to recover from? Absolutely, and the President deserved time to let his policies work.

At this point five years after the recovery officially began, the responsibility for this disappointing economy now lies squarely on this President. The excuse box is empty.

It is time to acknowledge that the President's seemingly insatiable appetite for more federal spending, higher taxes and excessive red tape on local businesses has produced an economy sputtering along at near stall speed. That has deprived millions of hardworking people, young and old alike, their opportunity to pursue the American Dream.

For the sake of millions of Americans seeking good jobs, we can no longer afford to simply 'stay the course'. We need to roll back the damaging economic policies that the Obama White House has inflicted on the American people.

To get our economy back on track we need to return to the proven free market principles that built the most prosperous country on the planet. We need to implement the economic policies—lower marginal tax rates, federal spending restraint, balanced regulations, a sound dollar, and opening foreign markets to American exports—that got America moving again under both President Kennedy and President Reagan.

We need to remember the words that one of our distinguished witnesses today, Larry Kudlow, has uttered so often over the years: "free-market capitalism is the best path to prosperity."

I look forward to the testimony today.

Testimony of Lawrence Kudlow for the U.S. Congress Joint Economic Committee**THE RECOVERY AT FIVE YEARS****Tuesday, July 15, 2014**

As we all know, the current economic recovery is sub-par. In fact, at roughly 2 percent average real growth over the past five years, it's the slowest rebound since World War II.

A few brief observations:

First, the massive federal stimulus of 2009-10 did not work. There were no so-called fiscal multipliers. And far too much debt was accumulated for no good reason.

Second, substantial overregulation has continuously hobbled the recovery. Tax rates have gone up across-the-board. The Dodd-Frank financial regulation has not solved Too Big to Fail, but it has contributed to an abnormally slow increase in C&I loans, particularly in the middle market. EPA overreach has created substantial uncertainties, as has the NLRB. Most of all, I believe the Affordable Care Act has thrown a wet blanket over the entire economy: Business hiring has been disappointing, even with rising profits. Part-time jobs are exploding. Full-time jobs are declining. Millions of people have dropped out of the labor force. Both the labor-force participation rate and the employment-to-population ratio remain near rock bottom. Wage gains are subnormal. And long-term business investment, which is typically a huge job-creator, has been disappointing to say the least.

The failure of business cap-ex may be the single biggest hole in the so-called economic recovery. That is why I believe slashing the corporate tax rate is the most important pro-growth measure that should be taken. I'd like to see the corporate tax completely abolished. But I'd settle for a 20 percent rate. (Incidentally, studies show that 70 percent of corporate tax relief goes to wage earners.) Additionally, investment cash expensing should be given 100 percent write-offs, all other credits and deductions should be eliminated, and corporate welfare and cronyism should be ended. And let me put a plug in for removing the Ex-Im Bank.

I do applaud the slowdown in federal spending, which has dropped from over 24 percent of GDP to below 21 percent. At least this gives the private sector more room to breathe. Large-scale budget reductions in 2011 and 2013 did not crash the economy or the moderate jobs recovery, as my Keynesian friends widely predicted.

Staying with fiscal-policy issues, leftist economists like Thomas Piketty who want 80 percent tax rates on the most successful have their data and story completely wrong. We should be flattening personal tax rates toward the 15 percent area and ridding ourselves of virtually all deductions and credits. Along with lower corporate taxes and more sensible regulations, these

supply-side reforms have the potential to grow the economy at 4 or 5 percent and make up for the \$1.5 trillion loss of potential GDP and the 6 million jobs gap. These figures are based on long-run baselines dating back to at least 1960.

The good news is the rise of the stock market, which has increased 190 percent from the depths of the 2008 meltdown. Total economic profits have increased 94 percent. And the profit-driven stock market rally (along with ultra-low interest rates) has contributed to a \$9.7 trillion increase in household net worth.

The problem is that not only have corporate profits not been invested in long-term capital projects, mainly as a result of tax and regulatory uncertainties, but firms are shifting cash overseas to avoid U.S. corporate tax penalties. You hate to see it, but low tax rates around the world attract cash, in this case almost \$2 trillion in American corporate cash. Policymakers should encourage the repatriation of this money with a modest 5 percent penalty rate.

Finally, a word about monetary policy. The massive \$3 trillion-plus buildup of the Fed's balance sheet -- somewhat akin to the explosion of federal-government spending -- did not work. Money multipliers have been collapsing along with the hand-to-hand rate of velocity. The zero Federal Reserve target rate, at five-years-plus after the financial meltdown, is too low and is contributing to a distortion of risk assessment in the financial markets. Moreover, the Fed has relapsed into the nonexistent Phillips-curve tradeoff between inflation and unemployment. Ms. Yellen's dashboard of labor-market indicators makes your head spin. That's no way to conduct policy. More people working does not cause inflation. Excess money and a devalued dollar do.

Miraculously, both actual and expected inflation indicators have stayed low. Perhaps that's because the actual money supply never exploded, as crashing velocity offset the rising monetary base. Preferably, future monetary policy will move back toward a rule-based approach, which prevailed during the prosperity of the 1980s and 1990s. I favor the Taylor rule, supplemented by market-based indicators such as gold, broad commodity indexes, the shape of the Treasury yield curve, and the dollar exchange rate. Right now, these indicators look pretty calm. So on the inflation front, I would suggest that the Fed declare victory and go home.

Regarding the disappointing labor market and sub-par economic growth in general, only pro-growth supply-side policies will fix the problems and put America back on the road to prosperity.

**July 15, 2014 Joint Economic Committee Hearing “The Recovery at Five: an Assessment”
Testimony submitted by Jared Bernstein, Senior Fellow, Center on Budget and Policy Priorities**

Chairman Brady and Vice-Chair Klobuchar, I thank you for the opportunity to assess the current recovery and applaud the committee for taking up this important topic.

Introduction/Summary

The official dates of the last recession are from December 2007—the peak of the previous recovery—to June 2009—the trough of the downturn. Given that we now have at least some economic data through the first half of this year, it is important to assess the progress that’s been made over the first five years of recovery.

In a review of trends of key variables including real GDP, jobs, unemployment and other measures of labor market slack, my testimony shows the following:

--Thanks in part to countercyclical policies legislated by Congress in 2009, along with aggressive monetary policy by the Federal Reserve, significant progress has been made in repairing the damage done by the uniquely deep recession that began in late 2007.

--These gains, while incomplete, are evident in the job market, particularly in the recent acceleration in job growth and decline in unemployment. After 52 consecutive months of net private sector job growth, non-government employment is up 9.7 million jobs since early 2010.

--Moreover, employment growth has accelerated in recent months. Payrolls added 1.4 million jobs in the first half of this year, their strongest six-month growth period since late 1999.

--Un- and underemployment are both down significantly over the recovery, as are other slack metrics that rose sharply in the downturn, including long-term unemployment and involuntary part-time work. While part of the decline in unemployment was due to labor force exits, this negative trend has also stabilized in recent months.

-- Private payrolls grew about 3% faster over the first five years of this recovery compared to prior recoveries, despite the fact that the recession that preceded this expansion was much deeper in terms of lost output and much longer lasting than the downturn that preceded the 2000s expansion. The private sector added 3.4 million more jobs in the first five years of this recovery than were added in the last one.

--Yet, slack remains in the job market and wage growth has generally not yet accelerated; real median household income, after falling sharply by around 10% in the downturn, is up about 3% over the past few years, largely due to more work at flat real earnings. Corporate profitability and financial market returns, on the other hand, have more than recovered their losses.

In other words, while there are many positive attributes to the current recovery, especially in relation to the depth of the recession that preceded it, it is clearly not yet reaching everyone.

Looking back at the “Great Recession,” policy actions taken by the Obama administration (as well as the George W. Bush administration) and Congress (fiscal and financial stability policies) and the Federal

Reserve (monetary policies) helped to stabilize key markets. Trends that were sharply negative, like real GDP, employment, or the increase in involuntary part-timers, either stabilized (employment rates) or started to grow (GDP, jobs). Though these actions have often been cast as ineffective or worse, the evidence points the other way. In this regard, the quick and forceful actions taken by some members of this committee and your colleagues back in the depth of the Great Recession were essential.

However, since then, factions within this Congress have far too often blocked measures that could have built on this stabilization, like the American Jobs Act or more recently, emergency unemployment compensation. Worse, Congress has at times imposed self-inflicted wounds on the economy, including the government shutdown, sequestration, and the threat to default on our national debt. The imposition of these headwinds has blocked progress on growth, jobs, and wages at a time when the opposite was needed. In fact, many of the same policy makers who today criticize the economic progress I'll document have at the same time blocked legislative initiatives targeted at improving that progress. It's one thing to critically point to the fire yet quite another to do so while blocking the hydrant.

I would thus summarize the message from this testimony as follows: when markets fail as massively as they did in the late 2000s, quick and forceful action clearly helps offset the damage. But to stop at stabilization, instead of rebuilding jobs and incomes that were lost over the downturn is a serious policy mistake, one that has proven to be extremely costly to working families. Still, as I conclude below, there is time to build on the recent momentum we've seen, particularly in the job market.

The testimony proceeds by briefly reviewing some salient facts about the sharp downturn that preceded the recovery and the countercyclical policies, most notably the Recovery Act, that targeted this large market failure. I then look at indicators over the last five years of recovery with an emphasis on the labor market, including jobs, unemployment, the labor force, and wages. Next, I review policy actions and inactions that have hurt the recovery, largely by creating fiscal headwinds that taken as a whole pushed hard against growth and jobs. I conclude with some diagnoses and prescriptions to build on the recent progress, measures that I urge the committee to consider in the interest of generating full employment and more broadly shared prosperity.

The Damage Done By the Great Recession

Evaluating this recovery first requires examining the uniquely deep recession that preceded it. Real GDP fell 4.3% from peak to trough, more than any other recession on record going back to the Great Depression. The average percent loss in real GDP in the prior seven downturns going back to the early 1960s was 1.3%. As officially dated, the Great Recession lasted 18 months, compared to the 10.2 months average length of every other post-war recession.

In the quarter before President Obama took office—2008Q4—real GDP declined at a nightmarish annual rate of 8.3%. Real investment, including businesses and housing, fell by over 30%. Employment fell by almost two million jobs in the last quarter of 2008 and by more than that—2.3 million—in the first quarter of 2009. Home prices—and it was a housing bubble that was at the root of the market failure—were in the midst of what would ultimately be a 34% price decline (Case-Shiller 20-city index). The S&P 500 fell by half between October 2007 and March 2009.

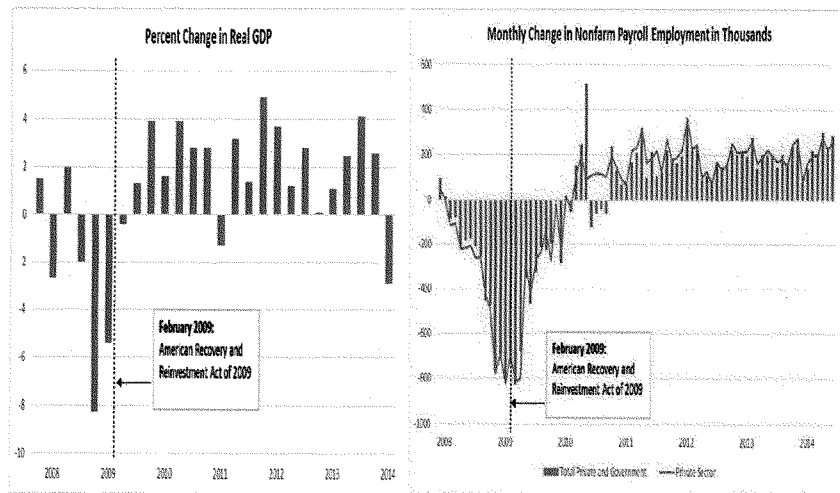
As noted, the roots of the recession were a massive housing bubble inflated by reckless and under-regulated finance. Once the bubble burst, the loss of trillions in housing wealth generated a negative wealth effect that sharply reduced consumer spending and ushered in a protracted period of deleveraging of household balance sheets. In a 70% consumption economy like ours, the negative wealth effect from the loss of something like \$8 trillion in housing wealth by itself ensured a deep demand contraction. In addition, research associated with economists Reinhardt, Rogoff, Koo, and Minsky all point to the particular tenacity of downturns born of underpriced risk in financial markets and the collapse in asset prices that inevitably follows.

In that regard, the extent to which countercyclical policy took effect, pulling the recovery forward and preventing the recession from becoming a depression was impressive. As I stress below, these efforts needed to continue longer than they did, but their effectiveness, reviewed next, is a matter of historical record.

The Countercyclical Policy Response

Less than four weeks into his first term, President Obama and Congressional Democrats passed the American Recovery and Reinvestment Act. A thorough review of the Act goes beyond my subject, which is the recovery that followed. But since the effectiveness of such policies is key to the later discussion and conclusion, I will note some salient facts regarding the Recovery Act and related policy actions.

The two figures below provide simple but compelling evidence regarding the impact of the Recovery Act and other countercyclical policies in play at the time. The first figure shows annualized quarterly changes in real GDP and the second shows monthly changes in total and private payrolls. A vertical line is drawn in February 2009 to show when the Recovery Act was passed.



Sources: BLS, BEA

Even given the massive headwinds noted above—hundreds of billions lost to consumer spending due to the negative wealth effect from the housing bust, the crash of credit markets, deleveraging of balance sheets—real GDP growth quickly turned from large negatives to positives shortly after the Act went into effect. The magnitude of job losses almost immediately began to diminish, and private employment gains appeared in early 2010.

Much more thorough and systematic research has been done on the question of the impact of both the Recovery Act and other measures, including financial stability initiatives and the Fed's monetary policy. In one of the most comprehensive studies of the impact of these measures, economists Alan Blinder and Mark Zandi concluded that the effects "...on real GDP, jobs, and inflation are huge, and probably averted what could have been called Great Depression 2.0. For example, we estimate that, without the government's response, GDP in 2010 would be about 11.5% lower, payroll employment would be less by some 8½ million jobs, and the nation would now be experiencing deflation."¹¹

The table below shows a broad set of research findings on the impact of the Recovery Act on real GDP from many non-partisan sources, including CBO and various market analysts. Though the magnitude of the findings vary, the results are uniformly positive, showing in 2010, for example, that the Act raised the level of real GDP by between 0.7% percent and 4.1%, with an average value of 2.5%.

Estimates of the Effects of the Recovery Act on the Level of GDP					
	Percent				
	2009	2010	2011	2012	2013
CEA: Model Approach	+1.1	+2.4	+1.8	+0.8	+0.3
CBO: Low	+0.4	+0.7	+0.4	+0.1	+0.1
CBO: High	+1.7	+4.1	+2.3	+0.8	+0.3
Goldman Sachs	+0.9	+2.3	+1.3	—	—
HIS Global Insight	+0.8	+2.2	+1.6	+0.6	—
James Glassman, JP Morgan Chase	+1.4	+3.4	+1.7	0.0	—
Macroeconomic Advisers	+0.7	+2.0	+2.1	+1.1	—
Mark Zandi, Moody's Economy.com	+1.1	+2.6	+1.7	+0.4	—

Note: Firm estimates were obtained from and confirmed by each firm or forecaster, and collected in CEA's Ninth Quarterly Report.

Sources: Congressional Budget Office, Estimated Impact of the American Recovery and Reinvestment Act on Employment and Economic Output from October 2012 Through December 2012; CEA Ninth Quarterly Report; CEA Calculations.

Source: 2014 Economic Report of the President

The Recovery

As with the last few business cycle expansions, real GDP growth proceeded job growth. As can be seen in the first figure above, real GDP began to grow in the second half of 2009. Since the job market is the source of economic returns for the majority of working-age households and thus a key conduit by which macroeconomic growth reaches most households, I focus heavily on its progress in the recovery.

Employment began to grow in early 2010 and has since accelerated, particularly recently:

¹¹ <https://www.economy.com/mark-zandi/documents/End-of-Great-Recession.pdf>

--Last month payrolls grew by 288,000 on net, the fifth consecutive month of payroll growth surpassing 200,000. For the first half of the 2014, payrolls were up 1.4 million jobs, the most first-half-year job growth in over a decade.

-- Moreover, job growth has solidly accelerated in recent months. For example, over the past three months payrolls expanded by about 270,000 per month, compared to about 200,000 per month a year earlier (i.e., taking the same three month average from 2013Q2).

--The table below compares the growth in payrolls, both total and excluding government, over the first five years of the past three expansions, each of which were initially labeled "jobless recoveries," because GDP growth proceeded job growth.

In popular discussion, the current jobs recovery is sometimes described as uniquely weak, but in fact, the pace of employment growth was considerably faster in this recovery compared to that of the 2000s. For example, private-sector payrolls grew by 4.7% over the first five years of the 2000s expansion, and 7.8% in this one. As the last column shows, that amounts to 3.4 million more private-sector jobs in this expansion versus the last expansion, five years out. This improved employment performance is particularly notable given how much deeper the last recession was relative to the brief and very shallow downturn in the early 2000s.

On the other hand, the 1990s recovery at age five was adding jobs at a faster clip than both of the next two recoveries.

Payroll Job Growth, Total and Private, First Five Years of Last Three Expansions				
	<i>Percent change</i>		<i>Millions of Jobs</i>	
	<i>Total</i>	<i>Private</i>	<i>Total</i>	<i>Private</i>
<i>This recovery</i>	6.0%	7.8%	7.8	8.5
<i>2000s</i>	4.5%	4.7%	5.9	5.1
<i>1990s</i>	9.6%	10.4%	10.4	9.4

Source: BLS, NBER (for recovery dating)

--Unemployment is now down to 6.1%, the lowest it has been since late 2008 and 3.9 percentage points down from its peak of 10% in late 2009. Importantly, the recent decline in the jobless rate occurred while the labor force participation rate was relatively constant. That implies that the fall in unemployment was due to job seekers finding work, not leaving the labor market, a problem I say more about below.

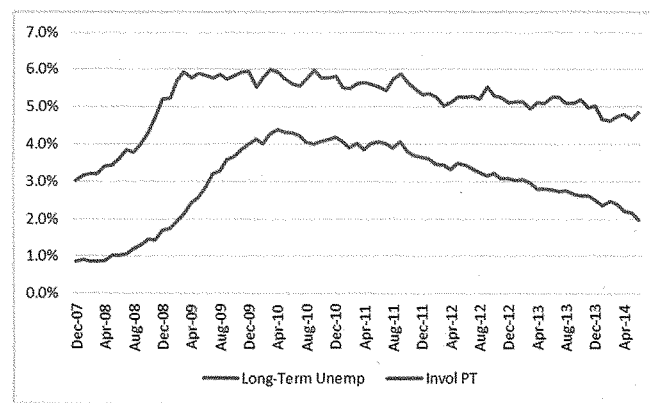
--Long-term unemployment (jobless for at least six months) also grew much more in this recession and the first few years of recovery far more than in the past. By late 2011, the long-term share of the unemployed peaked at 45% but it has been falling since and is now down to 33%. While that is welcome progress, it still represents an elevated share of long-termers among the unemployed.

--Underemployment, 12.1% last month, is down sharply from its peak of 17.1% in late 2009. This broader measure of labor market slack includes part-timers who would prefer full-time jobs but can't find them. Last month, there were 7.5 million such underemployed workers, down 650,000 over the past year and 1.5 million over the five-years of the recovery.

--Figure 3 shows both long-term unemployment and involuntary part-timers as a share of the labor force—two metrics that speak to the depth of labor market slack that grew sharply in the downturn and have slowly come down in the recovery. Long-term unemployment went from 1% of the labor force right before the recession began to slightly above 4% through 2010. Involuntary part-time work doubled as a share of the labor force, from 3% to 6%.

--As the job market began to improve, both these measures of slack have come down. Long-term unemployment has come down about two-thirds from its peak and involuntary PT, about 40%. Thus, both measures remain elevated but both are clearly improving as the recovery proceeds apace.

Figure 3: Long-term Unemployed and Involuntary Part-timers as Share of the Labor Force



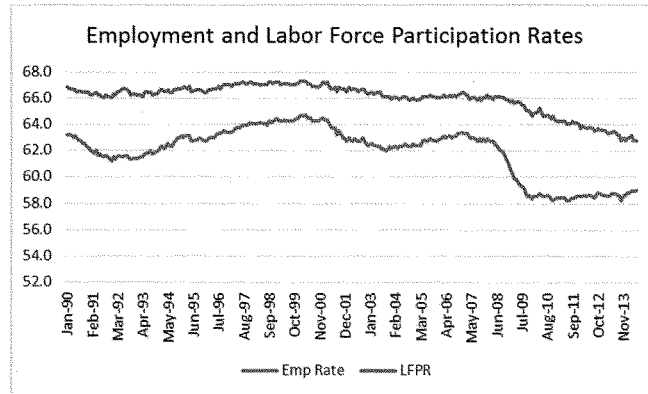
Source: BLS

In sum, the labor market has improved considerably over the recovery and that the pace of recovery has accelerated in recent months. However, slack remains and while each of these indicators show improvement, they all remain elevated. In this regard, achieving the critical goal of full employment requires that both monetary and fiscal policy should be working to complement and accelerate these favorable trends. Unfortunately, as I stress in the next section, regarding the latter—fiscal policy—this has not always been the case.

Less favorable trends include the decline in the labor force participation rate, the flat employment rate, and wage trends.

Figure 4 shows the share of the adult population in the labor force (i.e., either working or looking for work), otherwise known as the labor force participation rate, or LFPR, and employment as a share of the population. The employment rate fell sharply in the downturn, and stabilized in the recovery. Since its low point of 58.2% in mid-2011, it has slowly climbed a bit to 59%. Still, this trend reveals that employment growth has largely kept pace with population growth, a sign of insufficient labor demand.

The LFPR fell both in the Great Recession and through the recovery, shedding roughly three percentage points, from about 66% to about 63%. Since this is a steep decline of a critical growth input, much research has examined this trend.



Source: BLS

There are three factors to consider in explaining the decline in the LFPR since the recession. First, aging demographics are in play, as the leading edge of the baby boom are hitting their retirement years. Second, weak labor demand has been a factor, clearly for the non-elderly, but likely for older workers as well, as their LFPRs were increasing before the recession. Third, as Jason Furman points out in a recent analysis, longer term secular trends in the participation rates of prime-age workers (25 to 54 year olds), especially men, have been flat or falling for decades.²

In other words, there are two secular trends—retirement and long-term stagnation of LFPRs for prime-age males—and one cyclical trend—weak labor demand—behind the decline in the LFPR. Though there is disagreement on the precise role played by each factor, my summary of that work is that about half of the three point decline is related to weak demand.

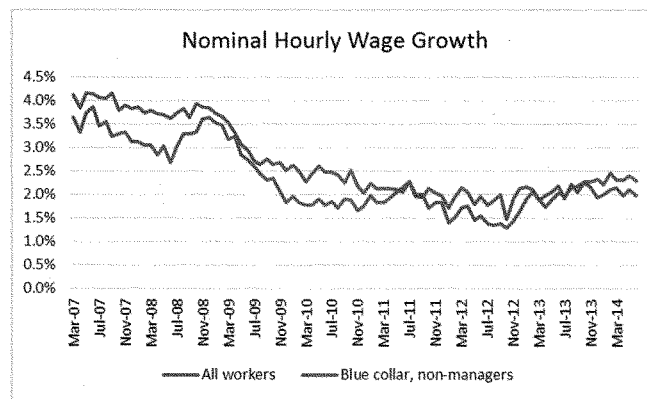
Importantly, that implies that stronger job growth and increased opportunities could thus stabilize and possibly—I'd say "probably"—reverse some of the decline. In this regard, it is highly notable that the LFPR appears to have stabilized in recent months. Since last August it has stayed within a 0.4 percentage point band, between 62.8% and 63.2%. The fact of this stabilization amidst accelerating job growth is a potentially favorable trend worth watching closely.

One of the most important reasons to squeeze slack out of the labor market is to generate faster wage growth. The figure below shows annual growth rates of nominal hourly wages for the overall average and for non-managers (i.e., blue collar workers in goods production and non-managers in services). As the deep slack in the job market operated with a lag, the pace of wage growth decelerated in 2009 and

² http://www.washingtonpost.com/opinions/unemployment-is-down-and-we-still-have-work-to-do/2014/07/04/7172bee6-0383-11e4-b8ff-89afd3fad6bd_story.html

stabilized at around 2%. There does appear to some acceleration in the wage growth for the non-managers' series, which bottomed out at around 1.5% in mid-2012 and is now growing about a point faster.

Given consumer inflation at about 2%, these nominal wage trends imply generally flat earnings in real terms. According to Sentier Research, a group that estimates the monthly growth in real median household income, this key measure of middle-class household living standards is up 3.3% over the past three years, likely representing the interaction between relatively flat real wages and more work, after falling about 10% between 2009 and 2011.³ These modest gains should serve as an important motivator for policy makers to correct past policy mistakes that have slowed the recovery, as discussed in the next section.



Source: BLS

Other favorable trends in the recovery include:

--As noted, the S&P 500 stock market index fell 50% over the downturn; since bottoming out in March of 2009, it has increased by 150%. Corporate profitability is up about 40% in real terms over the recovery.

--Housing prices are up 25% since their trough in early 2012.

Fiscal Headwinds and Self-Inflicted Wounds

As I stressed above, enough policy makers moved quickly in response to the sharp economic contraction that the recovery was "pulled forward" in time and many negative trends were stabilized or better. But starting in around 2010 and intensifying in later years, fiscal policy shifted from supporting the recovery to suppressing growth.

The two figures below, from Moody's Analytics, show the impact of various fiscal policies on GDP growth. In the first figure, the parts of the bars above the zero line show periods of fiscal tailwinds, or

http://sentierresearch.com/reports/Sentier_Household_Income_Trends_Report_May2014_07_02_14.pdf

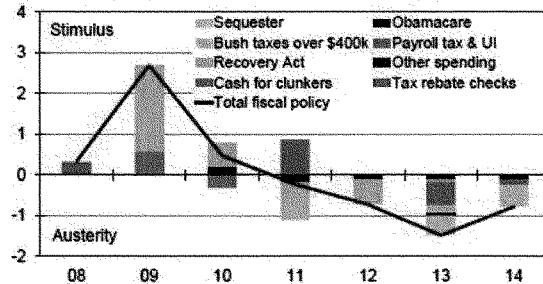
“positive fiscal impulse” and vice versa regarding the bars below the zero line. The Recovery Act hit back hard in 2009 but as it wound down—too soon, given the depth of continued weakness—fiscal headwinds began to blow in. By 2012, fiscal policy turned negative in terms of growth and in 2013, the negative fiscal impulse took 1.5 percentage points off of GDP growth.

Using standard rules of thumb, that extent of fiscal drag meant the unemployment rate was 75 basis points (hundredths of a percent) above where it would have been in 2013 absent those headwinds. Given a 2013 labor force of 155 million that amounts to a loss of about 1.2 million jobs.

Moody's second figure shows these same type of data but by quarter and isolating the impact of sequestration, along with the expiration of the payroll tax “holiday.” Note, for example, how the sequestration cuts were a significant contributor to fiscal drag in 2013 (though this effect was slightly offset by the bipartisan budget deal that reduced a portion of these spending cuts).

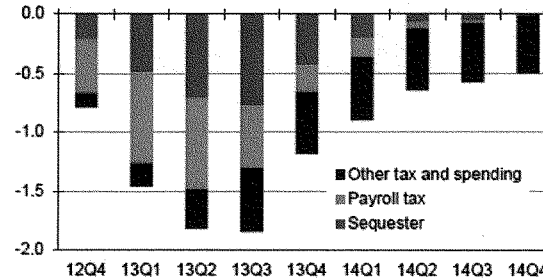
Fiscal Drag Begins to Wane

Federal discretionary fiscal policy contrib. to real GDP growth, %



Source: Moody's Analytics

Real GDP growth impact of fiscal austerity, ppts



Source: Moody's Analytics

While fiscal drag represents actions taken that slowed GDP, job, and wage growth, Congress also failed to take actions throughout the recovery intended to promote growth and jobs. A salient example is the American Jobs Act, proposed by President Obama in September of 2011. The proposal included

infrastructure investment, fiscal relief to strapped states, tax cuts targeted at workers and small businesses, and safety net measures targeted at the long-term unemployed. Independent analyses estimated that the act would boost real GDP growth by about 1.5%, generate about 2 million jobs, and lower the unemployment rate by about one point.⁴

In fact, some of these measures, like the payroll tax holiday and UI extension, saw the legislative light of day and they helped to generate some of the positive trends noted in earlier sections. But by failing to embrace the entirety of the act, Congress contributed to the fiscal drag shown in the above two figures.

The failure to further extend emergency unemployment compensation, despite the fact that long-term unemployment remains highly elevated, stands as the most recent example of recovery-enhancing actions not taken. According to analysis from the Center on Budget and Policy Priorities, almost 5 million unemployed persons will lose out of extended benefits this year.⁵ This is harmful “micro-policy” in the sense that while labor market slack is clearly diminishing, it is still substantial, and many of these unemployed people still need benefits to meet their consumption needs. But it is also bad macro-policy in terms of contributing to fiscal drag, creating additional headwinds against the underlying improvements documented throughout.

Finally, the threat to default on our national debt, the government shutdown, and the disruption of normal budget processes giving rise to fiscal cliffs have also been negatives for the economy. Not only do such events cause uncertainty in markets, but in the case of the shutdown, activities are disrupted in large swaths of the real economy, from tourism to private sector firms that contract with the federal government. A recent CRS report cites three estimates of the negative impact of the 16 day shutdown in October 2013, ranging from one-quarter to one-half a percentage point of real GDP and over 100,000 jobs.⁶

Conclusion

At five years old, the US economic recovery is finally showing signs of strength, particularly in the job market, where employment growth has accelerated in recent months. In fact, compared to the last recovery, payrolls have grown considerably faster at this stage, a fact that is more remarkable when one considers how much deeper the “Great Recession” was compared to the very short and mild recession that proceeded the 2000s expansion.

Unemployment has come down as well, along with other measures of slack, including involuntary part-time work and long-term joblessness. Through much of the recovery, however, the decline in unemployment was partly a function of the decline in the labor force, some of which reflected (and continues to reflect) weak demand. However, in recent quarters, as employment growth has accelerated, the LFPR appears to have stabilized, a very important improvement if it sticks.

The history I briefly review shows that the policy response to the deep recession was effective and stabilized key variables that were deteriorating at an alarming rate. But stabilization is of course but the first responsibility of countercyclical policy. These measures ended too soon to build on that

⁴ <http://www.americanprogress.org/issues/labor/report/2011/09/14/10246/the-american-jobs-act/>

⁵ <http://www.cbpp.org/cms/index.cfm?fa=view&id=4060>

⁶ <http://fas.org/spp/crs/misc/R43292.pdf>

stabilization and move the job market more quickly back towards full employment wherein many more Americans could benefit from the growth we've seen over the past five years.

While the administration and some members of Congress have tried to build on the progress so far, they have been blocked by others who through both negative actions (e.g., shutdown, sequestration) and inaction (e.g., failure to extend emergency UI) have slowed the recovery and reduced both GDP and job growth.

Though gridlock too often blocks such progress these days, Congress could still take action to build on the recent momentum, improving both the quantity and quality of jobs. Investment in infrastructure would be particularly smart policy right now, as borrowing costs remain low and there is great need to improve the nations' stock of public goods. While fiscal measures must always be weighed in terms of their impact on deficits, recent analysis by Laurence Ball et al shows that under current conditions, both the near and longer term economic payback to such investments would partially offset their costs.⁷

I should note that while the recent agreement to replenish the Highway Trust Fund is welcome in terms of maintaining our stock of public goods, such spending is already "in the baseline," and thus such spending represents no new "fiscal impulse" that would be expected to add to jobs or growth (in other words, patching the fund "does no harm").

Increasing the federal minimum wage to \$10.10 and then indexing, as proposed by Sen. Harkin and Congressman Miller, would help ensure that low-wage workers get a boost from the recovery that their low-bargaining power has heretofore blocked. Considerable research shows that moderate increases such as the one proposed in the Fair Minimum Wage Act have their intended effect of raising the pay of low-wage workers without leading to large job displacements.⁸

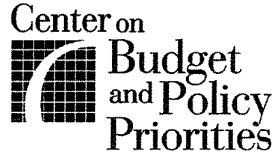
Members of this committee have suggested other good ideas to help the recovery reach more people in the areas of job training, women's financial security and equal pay, manufacturing policy, and extending emergency unemployment compensation.

The strong policy lesson of this recovery is that countercyclical policies work, but we must stick with them until the private sector demand contraction is solidly underway. Conversely, we've also learned that austerity and self-inflicted economic wounds do what most economists would expect: slow growth and dampen the pace of job gains.

While it would be naïve to ignore the sharp partisanship that prevails today, I still importune the members of this important and prestigious committee to apply these simple lessons in the interest of prolonging and strengthening our five year old recovery. Such actions would give the recovery a much better chance of reaching families that have thus far seen too little of it. Surely, we can all agree of the desirability of that outcome.

⁷ http://www.pathtofulleremployment.org/wp-content/uploads/2014/04/delong_summers_ball.pdf

⁸ <http://www.cbpp.org/cms/index.cfm?fa=view&id=4075>



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August 4, 2014

Rep. Kevin Brady (R-TX)
Chairman of the Joint Economic Committee
Washington, DC 20510-6602

Dear Chairman Brady:

Thank you for the opportunity to testify before the Joint Economic Committee (JEC) on Tuesday, July 15, 2014 to assess the economic recovery at five years. I would like to submit an official correction for the record to the committee.

During the question and answers portion of the hearing, Larry Kudlow stated that "70 percent of corporate profits goes to the workforce." In response to Mr. Kudlow's comment, I stated the following:

No, there has--I just wanted to point out that I think it is misleading to say that there has been "a lot of research that shows that corporate tax cuts redound to the benefits of labor." I can think of one or two papers, and I would just point out that as I recall, and I will check this--I think I'm right about it--that the CBO assumes half and half, not 70/30.

For purposes of correcting the record, I underestimated how far Mr. Kudlow was off in assigning the benefits of a corporate tax cut to workers, at least according to the following authoritative sources.

The Congressional Budget Office¹ assumes that 25% of business taxation is borne by workers (and thus, that is the share of any corporate tax cuts that would accrue to them). The Joint Tax Committee² assumes that 0% of corporate tax cuts would reach workers within the 10 year budget window, and 25% outside the window. The Tax Policy Center³ assume that 20% of the benefits would reach workers.

These estimates are clearly below my "50/50" recollection and even further below Mr. Kudlow's "70/30."

Again, thank you for the opportunity to correct the record on this important and timely topic.

Sincerely,

Dr. Jared Bernstein
Senior Fellow, Center on Budget and Policy Priorities

¹ <http://www.cbo.gov/sites/default/files/cbofiles/attachments/44604-AverageTaxRates.pdf>

² <https://www.ict.gov/publications.html?func=startdown&id=4528>

³ <http://www.taxpolicycenter.org/UploadedPDF/412651-Tax-Model-Corporate-Tax-Incidence.pdf>